83-863

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

MID AMERICA TELEVISION COMPANY
and OLIVER ADVERTISING, INC.,
Petitioners,

vs.

STATE TAX COMMISSION OF MISSOURI and
DENNIS K. HOFFERT, CHARIMAN and
STEPHEN C. SNYDER, COMMISSIONER,
Respondents;

WELLS ALUMINUM, INC.,
Petitioner,

vs.

ADMINISTRATIVE HEARING COMMISSION.
Respondent.

JOINT PETITION FOR A WRIT OF CERTIORARI

To the Supreme Court of Missouri

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QUESTIONS PRESENTED

Does the Missouri income tax law as construed by Respondents in determining the appropriate deduction for federal income tax liability for corporations which file consolidated federal income tax returns but which file separate Missouri income tax returns violate the equal protection provision of the Fourteenth Amendment of the Constitution of the United States by discriminating against corporations which derive a substantial portion of their incomes in interstate or foreign commerce?

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JOINT PETITION FOR A WRIT OF CERTIORARI

To the Supreme Court of Missouri

Mid-America Television Company, Oliver Advertising, Inc. and Wells Aluminum, Inc., petition that a writ of certiorari be issued to review the judgments and opinions of the Supreme Court of Missouri entered May 31, 1983.

OPINIONS BELOW

The Opinion of the Supreme Court of Missouri en banc in the case of *Mid-America Television Company and Oliver Advertising, Inc.* v. *State Tax Commission of Missouri* is reported at 652 S.W.2d 674 (Mo. en banc 1983). The official slip opinion of the

Missouri Supreme Court is printed in the Appendix at page A-1 and is No. 63297 in the Supreme Court of Missouri. The opinion of the Supreme Court of Missouri in *Wells Aluminum, Inc.* v. *Administrative Hearing Commission* is reported at 652 S.W.2d 687 (Mo. en banc 1983). The official slip opinion of the Missouri Supreme Court is printed in the Appendix at page A-20 and is No. 63348 in the Supreme Court of Missouri.

JURISDICTION

The judgments of the Supreme Court of the State of Missouri affirming the decisions of Respondents were entered on May 31, 1983. Timely Motions for Rehearing were denied on June 30, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1257(3). Because the questions sought to be reviewed on certiorari are to the same court and are identical, Petitioners are filing a joint Petition pursuant to United States Supreme Court Rule 19.4.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Section 1, Article XIV of the Amendments to the United States Constitution provides in relevant part:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty or property without due process of law, nor deny to any person within this jurisdiction the equal protection of the law.

Section 143.071 of the Missouri Revised Statutes, 1978, provides in relevant part:

> A tax is hereby imposed upon the Missouri taxable income of corporations in an amount equal to five percent of Missouri taxable income.

Section 143.171 of the Missouri Revised Statutes, 1978, provides in relevant part:

> A taxpayer shall be allowed a deduction for his federal income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed. . . .

Section 143.431.1 of the Missouri Revised Statutes, 1978, provides in relevant part:

> The Missouri taxable income of a corporation taxable under Sections 143.011 to 143.996 shall be so much of its federal taxable income for the taxable year...as is derived from sources within Missouri...The tax of a corporation shall be computed on its Missouri taxable income at the rates provided in Section 143.071.

Section 143.431.2 of the Missouri Revised Statutes, 1978, provides in relevant part:

> There shall be added to or subtracted from federal taxable income, the modifications to adjusted gross income provided in Section 143.121 and the applicable modifications to itemized deductions provided in Section 143.141. There shall be subtracted the federal income tax deduction provided in Section 143.171.

Section 143.431.3(1) of the Missouri Revised Statutes, 1978, provides in relevant part:

> If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within the state as determined in accordance with Section 143.451, then it may elect to file a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income.

Section 143.431.3(4) of the Missouri Revised Statutes, 1978, provides in relevant part:

> For each taxable year an affiliated group of corporations filing a federal consolidated income tax return does not file a Missouri consolidated income tax return, for purposes of computing the Missouri income tax, the federal taxable income of each member of the affiliated group shall be determined as if a separate federal income tax return had been filed by each such member.

STATEMENT OF THE CASE

During the tax year 1973, Petitioners, Mid-America Television Company (hereinafter "MATV") and Oliver Advertising, Inc. (hereinafter "Oliver") were members of a consolidated group of which Kansas City Southern Industries, Inc. (hereinafter "KCSI") was the parent corporation.[1] MATV and Oliver, as members of the KCSI consolidated group, were both included in the 1973 federal consolidated income tax return filed by KCSI and its affiliated corporations. Thus, neither MATV nor Oliver filed a separate federal income tax return for the tax year 1973.

MATV is a multi-state corporation doing business in Missouri as well as other states. Oliver, on the other hand, does business only in Missouri. MATV and Oliver were ineligible under

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[1] Pursuant to Supreme Court Rule 28.1, MATV and Oliver present the following list of affiliated corporations: Parent, Kansas City Southern Industries, Inc.; Affiliates, The Kansas City Southern Railway Company, Joplin Union Depot Company, Kansas City Terminal Railway Company, Trailer Train Company, Veals, Inc., Carland, Inc., DST, Inc., Wall Street Clearing, Boston Financial Data Service, Investors Fiduciary Trust Company, Portico, DST Computer Services, Pioneer Western, Pabtex, Inc., Rice-Garden Corporation, The American Coleman Company, Rycom Instruments, Inc., Lonestar-KC Concrete Tie Company and LDX Group, Inc.

Missouri law to file a consolidated Missouri income tax return for the year 1973. Therefore, MATV prepared a separate Missouri corporation income tax return for 1973 and allocated to Missouri that portion of its federal income which was derived from Missouri sources. In preparing this return, MATV computed its federal taxable income as though a separate federal income tax return had been prepared. Likewise Oliver, in preparing its separate Missouri corporation income tax return, computed its federal taxable income as if a separate federal income tax return had been filed.

MATV, Oliver and the other members of the affiliated group paid to KCSI an amount which KCSI determined to be the federal income tax liability of each member of the consolidated group. This amount was determined by KCSI to be the amount which each affiliated corporation would have paid in federal income taxes if each had filed on a separate basis. Thus, MATV and Oliver accrued a federal income tax liability as if each had filed a separate income tax return.

On their Missouri income tax returns, MATV and Oliver claimed deductions for their federal income tax liabilities in amounts equal to the amounts paid to KCSI pursuant to the aforementioned allocation (an amount equal to what the tax would have been had each filed a separate federal income tax return).

On May 28, 1975, the Missouri Department of Revenue issued a Notice of Deficiency to MATV and Oliver. The notice to Oliver assessed additional Missouri corporation income taxes for the year 1973 in the amount of $2,546.97 and interest in the amount of $152.81 for a total of $2,699.78. MATV was assessed additional Missouri corporation income taxes for the year 1973 in the amount of $2,506.62 and $125.33 in interest for a total of $2,631.95. In each instance, the reasons for the Department of Revenue's assessments were identical. The Department of Revenue disallowed the deductions for federal income tax liability claimed by MATV and Oliver and allowed MATV and

Oliver a lesser deduction based upon a proportion of the consolidated federal income tax paid by the affiliated group. The method employed by the Department of Revenue in determining this proportion, as sustained by Respondents, is the method of allocation found in 26 U.S.C. §1552(a)(1) [Section 1552(a)(1) of the Internal Revenue Code]. This method allocates to each member that portion of the tax paid by the group in proportion to the ratio of the member's taxable income to the consolidated taxable income.

MATV and Oliver timely filed Petitions for Abatement on August 26, 1975 and on November 9, 1976, the Director of Revenue sustained the deficiency notices as to MATV and on November 15, 1976 sustained the deficiency notices as to Oliver.

These final decisions were appealed to Respondent which affirmed the Director of Revenue in a decision issued on April 23, 1980. A Petition for Review was then filed in the Circuit Court of Jackson County on May 23, 1980. On July 22, 1981, the Circuit Court of Jackson County affirmed the decision of the State Tax Commission after having the case submitted upon the record. On July 31, 1981, MATV and Oliver filed Notices of Appeal to the Supreme Court of Missouri at which time MATV and Oliver raised the federal question that the deduction for federal income tax liability in the Missouri income tax law as construed by the Department of Revenue and affirmed by Respondent violated the equal protection provision of the Fourteenth Amendment of the United States Constitution.

The Missouri Supreme Court, in its opinion dated May 31, 1983, affirmed the judgment of the Circuit Court of Jackson County and rejected the Fourteenth Amendment argument. 652 S.W. 2d 674, 679-681. A timely Motion for Rehearing was denied on June 30, 1983.

Petitioner, Wells Aluminum, Incorporated, (hereinafter "Wells") was a member of a consolidated group of which Revere Copper and Brass Incorporated (hereinafter "Revere")

was the parent corporation.[2] Like MATV, Wells carries on a multi-state business, a portion of which is conducted in the State of Missouri. During the years 1974 through 1976, Wells joined with Revere and other members of the affiliated group in filing a consolidated federal income tax return. The members of the consolidated group were not eligible to file a consolidated Missouri income tax return during the years in question and, therefore, Wells filed a separate Missouri corporation income tax return. Like MATV and Oliver, Wells was ineligible to file a consolidated Missouri income tax return because more than fifty percent of the income of the consolidated group was derived from sources outside the State of Missouri.

In preparing its Missouri corporation income tax returns for each of the years in question, Wells computed its Missouri taxable income by allocating to Missouri that portion of its federal taxable income, computed as though a separate federal income tax return had been prepared, which was derived from Missouri sources. From the amounts so computed, Wells took a deduction equal to its federal income tax liability computed as though a separate federal income tax return had been filed.

Pursuant to an agreement among the members of the affiliated group and the financial accounting policy of the group, Wells, during the years in question, consistently paid to Revere an amount which it determined as its federal income tax liability computed on a separate return basis.

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[2] Pursuant to Supreme Court Rule 28.1, Wells presents the following list of affiliated corporations: Parent, Revere Copper and Brass Incorporated; Affiliates, John I. Paulding, Inc., Revere Copper Products, Inc., Revere Extruders, Inc., Revere Foil Containers, Inc., Revere Jamaica Alumina, Ltd., Revere Research, Inc., Revere Solar and Architectural Products, Inc., Revere Technology and Consulting Company, Inc., Revere Ware Courtesy Stores, Inc., Wells Aluminum Corporation, Wells Aluminum Southeast, Inc., Wells Aluminum Moultrie, Inc., and North American Aluminum Corporation.

On November 1, 1978, the Department of Revenue of the State of Missouri issued notices of deficiency of Missouri corporation income taxes for the tax years 1974, 1975 and 1976 respectively as follows: $34,093.00 in additional tax plus interest in the amount of $7,329.99; $20,895.00 in additional tax plus interest in the amount of $3,238.72; and $32,829.00 in additional tax plus interest in the amount of $3,118.75. As with MATV and Oliver, the reasons for these assessments were the disallowance of the claimed deductions for federal income tax liability and the recalculation of same pursuant to the method found in Section 1552 (a)(1) of the Internal Revenue Code.

After Wells had filed a timely protest letter, the Director of Revenue of the State of Missouri issued his final decision dated May 9, 1979 upholding the notices of deficiency for each of the years in question. Wells filed its complaint with Respondent, Administrative Hearing Commission of Missouri, on June 7, 1979 appealing the Director's final decision. The case was submitted to Respondent upon a stipulation and after briefs and argument, Respondent, Administrative Hearing Commission of Missouri, issued its decision on August 3, 1981 upholding the assessments and notices of deficiency of the Department of Revenue. During briefs and argument before Respondent, Administrative Hearing Commission of Missouri, Wells raised the federal question as to whether the deduction for federal income tax liability under the Missouri income tax law as construed by the Department of Revenue violated the equal protection clause in the Fourteenth Amendment to the United States Constitution. After Respondent's decision, Wells timely filed its notice of appeal to the Supreme Court of Missouri.

On May 31, 1983, the Supreme Court of Missouri en banc, relying on its decision in Mid-America and Oliver, affirmed the decision of the Administrative Hearing Commission. A Motion for Rehearing was timely filed and denied by the Supreme Court of Missouri en banc on June 30, 1983.

REASONS FOR GRANTING THE WRIT

A Writ of Certiorari should not be granted except in cases involving principles of public importance. *Rice* v. *Sioux City Memorial Park Cemetery,* 349 U.S. 70 (1955). This case presents a novel question of discrimination by the State of Missouri taxing authorities against corporations which derive substantial income from sources either foreign to the State of Missouri or in interstate commerce. It is of significant national importance since it effects all corporations doing business in interstate commerce. The discrimination in treatment among such corporations results in taxation by the State of Missouri of income which has no nexus in the State of Missouri. The result of the discriminatory treatment is that corporations, such as Petitioners, are required to pay more tax than their Missouri brethren but are required to compete in the market place on an equal footing. Thus, Petitioners believe that the discrimination described herein is the type of invidious discrimination which cannot be tolerated under the equal protection clause of the Fourteenth Amendment to the United States Constitution.

For all corporations filing Missouri income tax returns, the calculation of Missouri income tax begins with federal taxable income. Section 143.431.1 RSMO 1978. Section 143.171 RSMo 1978 allows all taxpayers filing Missouri state income tax returns a deduction for their "federal income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed. . ." Corporations taxable in Missouri are likewise entitled to this federal income tax deduction pursuant to Section 143.431.2 RSMo 1978. For corporations filing separate federal income tax returns, the derivation of this deduction is obviously quite simple.

For corporations filing Missouri consolidated income tax returns, the federal income tax deduction under Section 143.171 RSMo 1978 is likewise quite simple. The Missouri income tax law authorizes the filing of a consolidated Missouri return if an affiliated group of corporations files a consolidated federal in-

come tax return for the taxable year *and* fifty percent or more of its income is derived from sources within the State of Missouri. Section 143.431.3(1) RSMo 1978.

The issue confronting Respondents, however, concerned the calculation of such deductio[n] when an affiliated group of corporations, such as Petitioners, files a consolidated federal income tax return but does not meet the requirements of Section 143.431.3(1) RSMo 1978 because less than fifty percent of its income is derived from sources within Missouri. Section 143.431.3(4) RSMo 1978 requires each member of an affiliated group of corporations filing a consolidated federal return but filing separate Missouri returns to determine their federal taxable incomes as if a separate federal income tax return had been filed. Despite this provision, Respondents have disallowed the deduction for federal income tax liability computed on this identical basis by Petitioners.

Respondents ha[ve] [s]ustained the Missouri Department of Revenue's recomputation of Petitioners' federal income tax deductions employing the method of apportionment found in Internal Revenue Code Section 1552(a)(1). In effect, this section allocates the group's federal income tax liability to each member based on the share of the consolidated taxable *income* attributable to the member.

Even though all corporations subject to the Missouri income tax are taxed at a rate of five percent upon their Missouri taxable income (Section 143.071 RS 1978), Respondents' method of computing the deduction for federal income tax in cases such as those at bar results in such gross and inequitable differences in the amount of such deductions that corporations having the same incomes pay vastly different amounts in taxes. The impact of this discriminatory treatment is amplified by the realization that those corporations which derive more than 50% of their incomes from interstate or foreign commerce are realizing a lesser deduction, and therefore paying a greater tax, than those cor-

porations which derive more than 50% of their incomes from Missouri sources.

To demonstrate effectively the disparate treatment which Respondents' method necessarily dictates, Petitioners offer the following example:

The income of corporations X, Y and Z are the same in illustrations A, B, C and D.

Illustration A is 3 companies filing separate federal and Missouri returns and the calculation of Missouri income tax resulting therefrom.

Illustration B is 3 companies filing consolidated federal and consolidated Missouri returns because more than 50% of the consolidated income is derived from Missouri sources. This illustration similarly includes the calculation of the Missouri income tax.

Illustration C illustrates the example of 3 companies filing federal consolidated returns, but which file separate Missouri returns because less than 50% of the consolidated income is derived from Missouri sources. This illustration further demonstrates the impact of Respondents' method on tne Missouri income tax calculation.

Illustration D is a federal consolidated return for Companies X, Y and Z. The consolidated federal taxable income was $500,000 due to losses attributable to Corporation Y and the Federal Income Tax was $250,000.

A — FEDERAL SEPARATE AND MISSOURI SEPARATE

	X	Y	Z	Total (X & Z)
Separate federal taxable income	500,000	(250,000)	250,000	750,000
Add: State income tax	25,000	-0-	12,500	37,500
Deduct: Federal Income Tax on separate return basis	(250,000)	-0-	(125,000)	(375,000)
Missouri taxable income	275,000	-0-	137,500	412,500
Missouri tax at 5%	13,750	-0-	6,875	20,625

B — FEDERAL CONSOLIDATED AND MISSOURI CONSOLIDATED

	X	Y	Z	Consoli-dated
Separate federal taxable income	500,000	(250,000)	250,000	500,000
Add: State income tax	25,000	-0-	12,500	37,500
Deduct: Federal Income Tax	(250,000)	125,000	(125,000)	(250,000)
Missouri taxable income	275,000	(125,000)	137,500	287,500
Missouri tax at 5%	13,750	(6,250)	6,875	14,375

C — RESPONDENTS' METHOD UNDER FEDERAL CONSOLIDATED AND MISSOURI SEPARATE

	X	Y	Z	Total (X & Z)
Separate federal taxable income	500,000	(250,000)	250,000	750,000
Add: State income tax	25,000	-0-	12,500	37,500
Deduct: Federal Income Tax	(155,667)[1]	(-0-)	(83,333)	(250,000)
Missouri taxable income	358,333	-0-	179,167	537,500
Missouri tax at 5%	17,917	-0-	8,958	26,875

D — FEDERAL CONSOLIDATED RETURN

	X	Y	Z	Consolidated
Separate federal taxable income	500,000	(250,000)	250,000	500,000
Consolidating adjustments	-0-	-0-	-0-	-0-
Federal consolidated taxable income	500,000	(250,000)	250,000	500,000
Federal income tax at 50%	250,000	(125,000)	125,000	250,000

[1] Under Internal Revenue Code Section 1552(a)(1), Respondents would determine the appropriate deduction by dividing the separate taxable income for X (500,000) by the consolidated FTI (750,000) and multiplying that fraction by the consolidated federal income tax (250,000). A similar calculation would then be performed for Z.

Under Respondents' approach (Illustration C), the corporations pay $6,250 more in Missouri income tax than they would under the method used by Petitioners set forth in Illustration A. Moreover, because of the misfortune of these corporations in not deriving fifty percent of their income from Missouri sources, such corporations pay $12,500 more in Missouri income taxes than the same corporations would pay had they met such requirement under Illustration B.

At this point, it is important to point out that Petitioners do not herein assert that, because only corporations deriving fifty percent or more of their income from Missouri sources may file Missouri consolidated income tax returns, the Missouri income tax law therefore discriminates against corporations which do not meet such requirements. Nowhere in the *language* of the statutes is there a requirement that corporations which do not meet the fifty percent test must pay higher Missouri income taxes. Only by the construction of the statute advanced by the Department of Revenue as affirmed by Respondents does the discriminatory treatment arise. On a number of occasions, this Court has held that a statute, constitutionally valid on its face, may nonetheless be held constitutionally invalid as applied when it operates to deprive a party of a protected right. *Boddie* v. *Connecticut,* 401 U.S. 371 (1971); *Little* v. *Streater,* 452 U.S. 1 (1981).

Petitioners calculated their federal income tax liabilities on a separate return basis and paid that amount to their parents. As shown by Illustrations A and B, the Missouri income tax on separate corporations X and Z, corporations in the same posture as Petitioners herein, is identical. Under Illustration C, however, the Missouri income tax utilizing Respondents' method is substantially increased. Therefore, Respondents' method has created a new classification for corporations which file federal consolidated returns but may not file Missouri consolidated returns. Such corporations pay more tax than those corporations filing separate federal and separate Missouri

returns and pay more tax than those corporations filing federal and state consolidated returns. Under the method employed by Petitioners, on the other hand, Petitioners are on the same footing as all other taxpayers filing separate Missouri returns and, therefore, no discrimination exists.

The effect of Respondents' method in treating corporations such as Petitioners differently from other corporations in Missouri filing separate returns is to tax both income and losses derived by Petitioners' affiliated corporations from sources outside the State of Missouri or in interstate commerce. The disallowance of a portion of the deduction for federal income tax by Respondent in its ultimate and practical effect requires the utilization of losses sustained by affiliated companies. If there were no such losses sustained by other affiliated companies in the group, the allocation method adopted by the Missouri Department of Revenue and approved by Respondents would allocate to each of the Petitioners exactly what they now claim as a deduction. The amount by which Petitioners' separate federal income tax liability is reduced by this method is directly dependent on the magnitude of the losses generated by other companies in the group.

In footnote seven of the Missouri Supreme Court's principal opinion in *Mid-America Television* v. *State Tax Commission*, 652 S.W.2d at 681, the Missouri Supreme Court failed to comprehend the example cited in the dissenting opinion which is similar to the example set out above. The Court erroneously stated that the corporation filing a separate federal return "qualified" for the deduction while the corporation filing a consolidated federal return did not and rejected the notion that the statute is unfairly imposing a greater tax on one than on the other. However, under Section 143.171 RSMo 1978, *both* corporations "qualify" for the deduction. Respondents' reduction of this deduction for Petitioners creates a greater tax burden. Because Section 143.071 RSMo 1978 imposes the same five per-

cent tax on Missouri taxable income for all corporations, the inescapable conclusion is that Respondents' method increases the Missouri taxable income for corporations filing consolidated federal income tax returns. Furthermore, the ultimate byproduct of this is that Respondents' method imposes a tax on losses generated outside the State of Missouri thereby taxing business activity outside of Missouri's jurisdiction.

This Court has indicated three provisions of the Constitution under which a taxpayer may challenge a state tax which he alleges to be discriminatory. These are the Commerce Clause; the Privileges and Immunities Clause of Article IV, Section 2; and the Equal Protection Clause. *Western and Southern Life Insurance Company* v. *State Board of Equalization of California,* 451 U.S. 648 (1981). With respect to the equal protection clause, the Fourteenth Amendment forbids the States to "deny to any person within their jurisdiction the equal protection of the laws" although it does not prohibit the States from making reasonable classifications among such persons. *Lehnhausen* v. *Lake Shore Auto Parts Co.,* 410 U.S. 356 (1973). As stated in *Lehnhausen,* the test is whether the difference in treatment is an invidious discrimination and where no specific federal right apart from equal protection is imperiled, the States have large leeway in making classifications and drawing lines. 410 U.S. at 359. However, as stated in footnote three in *Lehnhausen,* discrimination against interstate commerce is the type of federal interest which will give rise to greater equal protection scrutiny. *See, Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U.S. 157 (1954).

The type of classification imposed by Respondents is analagous to those classifications examined by this Court involving tax provisions directed against out-of-state parties. As this Court stated in *Western and Southern Life Insurance Company* v. *State Board of Equalization of California, supra,* although a state tax classification should be sustained if it is rationally related to achievement of a legitimate state purpose, tax

provisions directed against out-of-state parties have been scrutinized more carefully by this Court. Thus, in *Wheeling Steel Corp.* v. *Glander,* 337 U.S. 562 (1949), the Court invalidated Ohio's ad valorem tax law which subjected intangible property of out-of-state corporations to a tax even though identical properties of Ohio corporations were not so taxed. In holding that the classification violated the Equal Protection Clause, the Court held that because the inequality was not the result of the slightest difference in Ohio's relation to the decisive transaction, but was solely on the basis of the residence of the owner, the classification was unconstitutional.

More recently, in *WHYY, Inc.* v. *Glassboro,* 393 U.S. 117 (1968), this Court struck down a New Jersey statute which exempted non-profit corporations incorporated in New Jersey but denied an exemption for non-profit corporations incorporated in other states. Following the long-standing principle that, once a state has permitted a foreign corporation to do business in the state, it must grant such corporations equal protection with the state's own corporations, this Court declared the New Jersey statute unconstitutional as violative of the equal protection clause because the state advanced no justifiable distinction between out-of-state and domestic corporations which would justify the inequality of treatment. *Id.* at pages 119-120.

This Court summarized the development of the law in this area in *Western and Southern Life Insurance Company* v. *State Board of Equalization, supra,* as follows:

> In view of the decisions of the Court both before and after *Lincoln National,* it is difficult to view that decision as other than an anachronism. We consider it now established that, whatever the extent of a State's authority to exclude foreign corporations from doing business within its boundaries, that authority does not justify imposition of more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations, unless the discrimination between foreign and domestic

corporations bears a rational relation to a legitimate state purpose. *Id.* at pages 667-668.

As stated before, there is nothing inherently discriminatory about the language of the Missouri income tax law. While the statute does classify corporations with respect to whether such corporations have filed consolidated federal income tax returns and whether the consolidated group derives fifty percent or more of its income from Missouri sources, this classification by itself does not create a higher tax burden for those corporations which do not meet that classification. However, as applied by the Missouri Department of Revenue and approved by Respondents, the inability of corporations which fail to meet the fifty percent test to deduct their separate return federal income tax liability effectively imposes a tax on the foreign income and losses of the affiliated corporations. This is not, therefore, the situation where a statute regulates "evenhandedly" as this Court discussed in *Minnesota* v. *Clover Leaf Creamery Co.*, 449 U.S. 456 (1981) but rather, as indicated in that case, is the type of regulation which discriminates against interstate commerce and has heretofore been consistently struck down. *Id.* at page 472.

Irrespective of the impact of the classification upon foreign and interstate commerce, Petitioners fail to see any basis, much less one which is rational, for the Missouri Department of Revenue method of computing the federal income tax liability deduction. As stated in the dissent in *Mid-America,* there is no justification for employing two different standards for taxation of corporations within the same class. All corporations that file separate returns in Missouri should be treated equally. *Id.* at pages 683-684. While the equal protection clause does not deny the states the power to classify persons, it does deny the states the power to classify persons on the basis of criteria wholly unrelated to the objective of the statute. *Eisenstadt* v. *Baird,* 405 U.S. 438 (1972).

As noted in the dissenting opinion in *Mid-America,* the majority opinion attempts to rationalize the classification on the basis that the Petitioners chose to do business as part of an affiliated group and, therefore, there may be tax advantages in filing consolidated federal income tax returns. 652 S.W.2d at 681. However, as discussed in the dissenting opinion at page 683, the only legitimate *state* concern is what happens at the state and not the federal level. There is clearly no rational basis for a state to impose a greater tax burden on a corporation which obtained some benefit because the affiliated group of which it is a part had an overall tax savings by filing a consolidated federal return. This is certainly not the sort of legitimate and rational state interest for which this Court has upheld discriminatory classifications under equal protection attack in the past; i.e. *Minnesota* v. *Clover Leaf Creamery Co., supra,* environmental considerations; *Lehnhausen* v. *Lake Shore Auto Parts Co., supra,* administration and enforceability distinctions.

In summary, Petitioners submit that the classification imposed by the Missouri Department of Revenue in refusing to allow Petitioners the same deduction for federal income tax liability as other corporations filing separate Missouri income tax returns has no fair and substantial relation to the object of the Missouri income tax law. Moreover, because Petitioners are not allowed by statute to file consolidated Missouri income tax returns, and because reduction in the amount determined by Respondents to be appropriately deductible was necessarily the result of losses incurred by out-of-state affiliated corporations, the classification necessarily increases the tax burden on these corporations and thereby taxes the incomes of such corporations derived from sources without the State of Missouri and the incomes of affiliated corporations derived from sources without the State of Missouri.

CONCLUSION

For the foregoing reasons, Petitioners request a Writ of Certiorari to review the judgment and opinion of the Supreme Court of Missouri.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Byron E. Francis, appearing on behalf of Petitioners, Mid-America Television Company, Oliver Advertising, Inc. and Wells Aluminum, Inc., certifies, as a member of the Bar of the United States Supreme Court, that three copies of this Petition have been sent, via first class mail to Richard L. Wieler, Assistant Attorney General of the State of Missouri.

Byron E. Francis

APPENDIX

APPENDIX A

SUPREME COURT OF MISSOURI
en banc

No. 63297

Mid-America Television Company, and
Oliver Advertising, Inc.
Appellants,

v.

State Tax Commission of Missouri, and
Dennis K. Hoffert, Chairman, and
Stephen C. Snyder, Commissioner,
Respondents.

APPEAL FROM THE CIRCUIT COURT OF
JACKSON COUNTY

Honorable James A. Moore, Judge

We have jurisdiction of this appeal because it involves construction of the revenue laws. Mo. Const., art. V, § 3. The question presented is whether a subsidiary of a parent company is entitled to deduct for Missouri income tax purposes what the subsidiary would have paid in federal income tax had it filed a separate federal return, rather than being included by the parent corporation in the latter's consolidated return.[1] The same issue

[1] Consolidated tax returns are popular with American corporations. In 1977, 46,663 consolidated tax returns were filed, including 142,000 subsidiaries. Total assets of corporations filing consolidated returns for 1977 amounted to about 64 per cent of the total assets of all corporations reporting and income tax from consolidated returns totalled 73 per cent of all corporations reporting. F.W. Peel, Jr. Consolidated Tax Returns (2d Ed.) 1982 Cum. Supp. (Aug. 1982) Section 0.02.

and largely the same arguments pro and con are presented in four other cases which were argued and submitted on the same day as the present case and which are being handed down concurrently: No. 63348, Wells Aluminum Inc. v. Administrative Hearing Commission; No. 63660, Cities Service Gas Company v. Administrative Hearing Commission; No. 63667, Bemis Company, Inc., d/b/a Louisiana Plastics, Inc. v. Administrative Hearing Commission and Bemis Company, Inc., d/b/a Western Litho Plate & Supply Company v. Administrative Hearing Commission and No. 63706, Banquet Foods Corporation v. Administrative Hearing Commission.

In each instance the taxpayer is seeking to deduct on its Missouri income tax return the full amount of what would have been the taxpayer's federal income tax for the year in question had the taxpayer filed an individual, separate federal income tax return. In each instance the director of revenue disallowed the proposed deduction and instead allowed only a proportionate share of the group's federal tax, which, with minor variations, was ascertained by multiplying the total federal income tax paid by the group times a fraction consisting of the taxable income of the member as the numerator and the taxable income of the entire group as the denominator. The effect of this is to allow the member taxpayer to deduct a portion of the federal tax paid by the group based on the relationship of the member's taxable income to the taxable income of the entire group.

During the tax year 1973, appellants Mid-America Television Company (MATV) and Oliver Advertising, Inc. (Oliver) were members of consolidated group of corporations of which Kansas City Southern, Inc. (KCSI) was the parent corporation. Appellants were included in the 1973 federal consolidated income tax return filed by the parent company, KCSI, and its affiliated corporations. The federal income tax paid by the parent corporation under the consolidated return was $14,900.00.

In their Missouri income tax returns, appellants claimed a deduction, respectively, for federal income tax in amounts equal to what the tax would have been had each filed a separate federal income tax return - MATV $63,531.00 and Oliver $50,491.00. These amounts were, in fact, paid by appellants respectively to the parent corporation pursuant to an agreement among the various members of the consolidated group and then by the parent company reimbursed to the loss companies within the group, thereby recognizing the savings to the group of federal tax brought about by the losses incurred by the loss companies. Stated another way, the payments collected from the members of the group in excess of the consolidated federal income tax liability were distributed to those companies whose negative tax liability created the excess.

The department of revenue filed notice of deficiency against appellants, showing additional tax of $2,506.62 and interest against MATV and $2,546.97 and interest against Oliver. The department took the position that appellants would be entitled to deduct only their proportionate share of the actual federal income tax liability of the group. Over appellants' objections, the deficiency notices were sustained and following adverse decisions by the State Tax Commission and the circuit court of Jackson County, appellants appealed here. We affirm.

Although appellants elected to file a consolidated federal income tax return, they were required to file separate state income tax returns as more than 50 per cent of their income was derived from sources outside the state. Section 143.431.3(1), RSMo 1978.[2] Missouri allows the individual members a deduction for their Missouri adjusted gross income equal to the "federal income tax liability" of that member. Section 143.171.1 provides:

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[2] Unless indicated otherwise, all statutory references are to RSMo 1978.

> "A taxpayer shall be allowed a deduction for his federal income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed . . ."

Appellants, however, as said, did not actually file separate federal income tax returns, so we necessarily must look elsewhere to determine appellants' federal tax deduction in arriving at Missouri taxable income.

Section 143.431.3(4) provides:

> "For each taxable year an affiliated group of corporations filing a federal consolidated income tax return does not file a Missouri consoidated income tax return, for purposes of computing the Missouri income tax, the federal taxable income of each member of the affiliated group shall be determined as if a separate federal income tax had been filed by each such member."

Under this statute, a member of a consolidated group determines its "federal taxable income" allocable to Missouri as if it had filed a separate federal return. Another statute, § 143.431.1, defines "Missouri taxable income" for corporations in terms of federal taxable income. The statute provides:

> "The Missouri taxable income of a corporation taxable under § 141.011 to 143.996 shall be so much of its federal taxable income for the taxable year, with the modifications specified in subsections 2 and 3 of this section, as is derived from sources within Missouri as provided in section 143.451. The tax of a corporation shall be computed on its Missouri taxable income at the rates provided in section 143.071."

Hence, federal taxable income, determined "as if a separate federal income tax return had been filed", becomes the amount of Missouri taxable income to the extent derived from sources

within Missouri, but we note that the hypothetical method of computation is mentioned only with regard to computing the taxpayer's "federal taxable income". No hypothetical method is mentioned as to the Missouri deduction for federal income tax.

Appellants would read the foregoing statutes to allow a member of an affiliated group, filing a separate state return, to deduct on its state return the amount of federal income tax it (the member) would have paid to the federal government had it filed a separate federal income tax return. Appellants argue that inasmuch as § 143.431.3(4), *supra,* directs a member of an affiliated group filing a separate state return to determine its federal taxable income as if it had filed a separate federal return, it follows that such member should also determine its federal income tax deduction in the same manner, i.e., as if it had actually paid such federal income tax. Appellants contend that the term "federal income tax liability" as contained in § 143.171.1, *supra,* does not require actual payment of tax to the federal government; that "liability" pertains only to the amount for which they would have been liable had they filed separate federal returns; that the statute does not specify that the "liability" must be payable to any certain entity.

In Armco Steel Corporation v. State Tax Commission, 580 S.W.2d 242 (Mo. banc 1979), this court held that, under the prior law, § 143.030-1, RSMo 1969, which provided for a deduction on the Missouri return for taxes on income "assessed by the United States against the taxpayer as the gross income from all sources within the state shall bear to the gross income of the corporation from all sources", the parent company of a consolidated group filing a consolidated federal income tax return, must determine its deduction for federal income tax on the basis of its proportionate share of the federal income tax for that year actually paid by it and its subsidiaries, not on the basis of what the federal income tax would have been had the parent reported as a separate entity; that taxes on income "assessed by the United States" meant the taxes actually paid.

Appellants contend that the change made in the Missouri income tax laws effective January 1, 1973 requires a different result in this case; that the prior statute allowed a deduction for "taxes assessed", but that under the new statutes, §§ 143.171 and 143.431, a deduction for "federal income tax liability" replaced the "taxes assessed" language; that the change in the statutes was intended to allow for the deduction denied under the prior statute in *Armco;* that had the legislature intended "taxes assessed" to mean the same thing as "federal income tax liability", it would have left the statutory language the same.

We believe appellants misread the statutes. Since Missouri income tax is based upon federal taxable income, see § 143.431.1, *supra,* some means was necessary to provide corporations required to file Missouri tax returns with a starting point when those corporations were members of an affiliated group which had filed a consolidated return for federal purposes. Such a member corporation would not have a federal taxable income of its own because an individual return was not filed with the federal government; the only federal taxable income available would be that of the affiliated group of which the corporation was a member. In such cases, § 143.431.3(4), *supra,* allows the individual member required to file a Missouri return to determine its federal taxable income as if a separate income tax return had been filed. Federal taxable income is whatever it turns out to be, regardless of what tax it entails. Federal taxable income can be calculated without reference to the taxes assessable thereon under the Internal Revenue Code.

Once the starting point - federal taxable income - has been determined, § 143.431.2 allows the corporations such as appellants to deduct under § 143.171 its share of the federal tax liability of the consolidated group.[1] The latter section provides

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[1] The pertinent part of § 143.431.2 provides: "There shall be deducted the federal income tax deduction provides in section 143.171." The pertinent part of section 143.171 has been set forth earlier herein, page 3, *supra.*

the taxpayer "shall be allowed a deduction for his income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed." Where a corporation derives only part of its income from sources within Missouri, the deduction available under § 143.171 for federal income taxes is allowed only to the extent applicable to Missouri, § 143.451.8.*

Section 143.091 states that any term used in the Missouri income tax law is to have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required by the statutes. The Internal Revenue Code is contained in 26 U.S.C. § 1, *et seq.* Chapter 1 is contained in Subtitle A of the Internal Revenue Code and is entitled "Normal Taxes and Surcharges". Nothing in Chapter 1 relates to intercompany payments, or any sums other than those assessed and payable to the United States government as federal income tax. Under Chapter 6 of the Internal Revenue Code, 26 U.S.C. § 1501, authority for an affiliated group of corporations to file a consolidated return is found, but the section specifically points out that the return is in connection with the income tax imposed by Chapter 1 of the Code. The several liability of the member or subsidiary with respect to the consolidated return is not what the federal income tax would have been for the subsidiary had it filed and been liable on a separate return, but is for the tax computed in accordance with the consolidated return. It is severally liable for the tax liability of the group. See 26 CFR 1.1502-6(a), entitled "Several liability of members of the group" (1982). In the case at bar, the only amount paid as a federal income tax liability for the year 1973 was the amount paid by the affiliated

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* The extent applicable to Missouri is determined by mulitplying the amount that would otherwise affect Missouri taxable income by the ratio of the Missouri taxable income divided by the taxable income as though the corporation had received all its income from Missouri sources.

group to which the appellants belonged, $14,933.00. The Missouri income tax statutes only allow a deduction for the federal income tax liability under chapter 1 of the Internal Revenue Code. Deductions from tax are a matter of legislative grace and appellants must demonstrate that they come within the terms of the statute which they claim grants them a privilege. Armco Steel Corporation, *supra,* at 245; Mobil Oil Corporation v. State Tax Commission of Missouri, 513 S.W. 2d 319, 322-22 (Mo. 1979). Appellants have not met that burden. The language of the new statute does not allow a deduction for hypothetical taxes or inter-company payments.

Study of the statutes in their aggregate discloses that the substantive change in the statutes in question from those in force before 1973 is unrelated to the amount of the federal income tax deduction and deals, instead, with the procedural difficulties encountered under the former statute as to the taxable year in which the federal income tax deduction will be allowed in cases where the federal income tax arises from a past taxable year. The new statute, § 143.171.1, it will be noted, allows a deduction from Missouri income tax for "federal income tax liability . . . for the same taxable year for which the Missouri return is being filed . . ." This means the taxpayer must take its deduction in the year for which it was liable for the additional assessment. Under the former statute there were major problems as to the tax return year in which the deduction should be taken: whether it was the year the taxpayer was liable for the additional federal income tax, or the year the additional income tax was discovered and the right to the Missouri deduction accrued to the taxpayer, or the year the additional income was "assessed", which the *Armco* decision declared was when the tax is actually paid into the United States Treasury. The difference in years may be important, as one year contrasted to another may involve tax rate changes or allocation rate changes, or whether there might be a bar of the statute of limitations, or whether the additional federal income must be accounted for in

Missouri as concomitant Missouri taxable income. The 1973 amendment avoids the aforementioned procedural problems by changing the year in which the deduction is allowed from the year the taxes were "assessed" to the year for which the return was filed. This change allows the deduction to be based on the tax and allocation rates of the year of the federal tax which allows for the Missouri deduction.

Appellants state that it is presumed that the legislature in enacting a new statute on the same subject as the old statute intended to effect some change in existing law, citing Kilbane v. Director of Revenue, 544 S.W. 2d 9, 11 (Mo. 1976). This is generally true, of course, but it also is true that the purpose of a change in the statute can be clarification. State ex rel. Laclede Gas Co. v. Public Service Commission, 535 S.W. 2d 561, 567 (Mo. App. 1976). Certainly it does not follow that because we do not agree with appellants that the new law permits a deduction for what their federal income tax liability would have been had they filed separate federal returns, this means that the legislature engaged in a useless act in enacting the new statutes which have been under discussion. On the contrary, as demonstrated above, numerous changes have been effected, but with respect to the matter of deduction the changes to go to the timing of the deduction and not to the issue at hand. We are convinced that the change in the Missouri federal income tax deduction statute was not concerned with the amount of the deduction, but with the many procedural irregularities that arose under the prior statute.[5]

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[5] Other illustrations are found in § 143.601, RSMo 1978 which makes it a requirement that taxpayers report any changes in their Missouri return for the year in which it was liable for the taxes on additional income and in § 143.711, RSMo 1978, which removes the former four-year statute of limitations and substitutes a period of one year in which the department can issue an additional assessment, once it becomes aware of a taxpayer's failure to comply with § 143.601.

Appellants cite Cities Service Gas Co v. McDonald, 204 Kan. 705, 466 P. 2d 277 (1970), which was also relied upon by the taxpayer in *Armco, supra,* as being directly in point, saying that the change in Missouri statutes requires the same favorable result for the taxpayer here, "in that a separate return basis is called for". We disagree. The Kansas court relied on the provisions of the Kansas statute, KGS 79-3202(8), G.klS. 1949, which provided the word "paid" with respect to the deduction for federal income taxes paid during the year meant " 'paid or incurred' or 'paid or accrued' and shall be construed in accordance with the method of accounting used as a basis for computing net income under this act." The Kansas court held that the taxpayer "actually incurred and paid federal income tax" under the accounting procedure followed by it and the parent company - that it was the same as if the subsidiary had filed an individual return. To the Kansas court, payment by the subsidiary to the parent company of the amount of federal income tax as shown on its separate federal return filed with the parent constituted a tax liability "incurred and paid" by the subsidiary and also, therefore, a deduction from net income in its Kansas income tax return. Missouri statutes contain no such definition of the word "paid" with respect to the federal income tax deduction and, as earlier pointed out, the Missouri statutes allow a deduction only for federal income tax liability under Chapter 1 of the Internal Revenue Code. There is no provision in the Missouri law allowing a deduction to a subsidiary included in a consolidated federal return for what the subsidiary would have paid the federal government had it filed a separate federal return.

Appellants further contend respondent's method for determining that allowable federal income tax deduction and § 143.431 constitute a denial of equal protection and violate that part of art. X, § 3 of the Missouri Constitution which provides "Taxes . . . shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax." Appellants point out they are part of an affiliated group which

does not derive 50 per cent of more of its income from Missouri, so that they are barred by § 143.431.3(1) from filing a Missouri consolidated return; that the decision below places them in a class for taxation to which they do not naturally and reasonably belong and makes them pay more in taxes than those in another consolidated group qualifying to elect to file a Missouri consolidated return or than those corporations which file separate federal and separate Missouri returns; that § 143.431 establishes a classification resting upon no reasonable basis; that classification based upon the geographical source of consolidated income does not accomplish or promote any state policy.

Uniformity of taxation does not require that all subjects of taxation be taxed, and it does not mean universality; it only requires that taxes be uniform as to each class upon which they fall. Virden v. Schaffner, 496 S.W. 2d 846, 848 (Mo. 1973); State ex rel. Jones v. Nolte, 350 Mo. 271, 165 S.W. 2d 632, 636 (banc 1942). The requirements of § 143.431 and the method by which the director computes the deductions for federal taxes paid by single members of an affiliated group fall alike on all taxpayers. Under 143.431, any affiliated group of corporations which filed a consolidated federal income tax return and derives 50 per cent or more of its income from sources within this state may file a Missouri consolidated income tax return. The tax imposed falls equally upon all members within this classification; the tax imposed falls equally on all taxpayers outside this classification.

The power of the state to classify for the purpose of taxation is broad. For income tax purposes, the taxpayer may be classified upon the reasonable basis of legal organization or the amount or source of income. Ludlow-Saylor Wire Company v. Woolbrinck, 275 Mo. 339, 205 S.W. 196, 199-200 (banc 1918). In this connection it is helpful to be aware of the basic reason for allowing corporations to file consolidated returns. Speaking of the federal statutes, one court has said:

> "The basic purpose behind allowing corporations to file consolidated returns is to permit affiliated corporations, which may be separately incorporated for various business reasons, to be treated as a single entity for income tax purposes as if they were, in fact, one corporation." American Standard, Inc. v. United States, 602 F. 2d 256, 261 (Ct. Cls. 1979)

See, also, Federal Income Taxation of Corporations and Shareholders, Bittker and Eustice (4th Ed. 1979), § 15.20:

> "The basic principle of the consolidated return is that the group is taxed upon its consolidated taxable income, representing principally the results of its dealings with the outside world after the elimination of intercompany profit and loss."

And, at § 15.23:

> "The basic concept underlying these provisions is that the consolidated group constitutes, in substance, a single, taxable enterprise, despite the existence of technically distinct entities . . ."

Recognition thus has been given to the fact that a group of separate entities under law should be taxed as one when their relationship is such that they can be said to be pursuing a single business purpose. It is not unreasonable that the legislature might decide that an affiliated group of corporations could, under certain circumstances, be taxed somewhat equally with one large corporation performing the same business operations within the same taxing jurisdiction.

The same basic premise can be stated for the allowance of consolidated returns in Missouri. Under certain circumstance, the state is willing to treat an affiliated group pursuing a single business purpose similarly to a single business enterprise. When viewed in this light, the requirement of § 143.431.3(1) that an affiliated group filing a consolidated federal income tax return

must derive 50 per cent or more of its income from sources within the state in order to file a Missouri consolidated income tax return is reasonable. A group deriving less than half of its income from sources within this state can hardly be said to be conducting a unitary business within the state. It is not unreasonable for Missouri to decline to accord such a group the same tax treatment available to a single entity performing all or most of its business operations herein.

This is especially true since the state is only allowed to tax corporations on income derived from sources within this state. The state has little reason to treat an affiliated group as a single taxpaying entity when less than 50 per cent of the group's income is derived from sources within the state, since the income earned by the members of the group outside the state is beyond the state's power to tax. Where less than 50 per cent of a group's income is derived from sources within this state, the constitutional provisions invoked do not preclude the state from imposing the requirements of § 143.431.3(1). The fact that more tax may be owed to the state of Missouri by one corporation under one set of circumstances rather than another, without some showing of discrimination or arbitrary or unreasonable classification, is not sufficient to support appellants' claim of constitutional infirmities.

Finally, we note that appellants chose to do business as members of an affiliated group which does not do more than 50 per cent of its business in Missouri. Having put themselves in that position, they are not so situated as to question the burden, if such it proves to be in fact, of not being able to be included in a consolidated Missouri income tax return. St. Louis Public Service Company v. City of St. Louis, 302 S.W. 2d 875, 879-881 (Mo. banc 1957); DeMay v. Liberty Foundry Co., 327 Mo. 495, 37 S.W. 2d 640, 644 (1931). The choice to become part of an affiliated group is legitimate, of course, and there are instances where there is a tax advantage in filing a consolidated federal income tax return to lessen the group's tax liability and permit the

funnelling of the savings directly back into the group of subsidiaries for immediate business use. In choosing to operate as a group, however, appellants voluntarily removed themselves from the class with which they now seek to be identified.[6] Additionally, as said earlier, the issue before the tax authorities and on this appeal is the amount of a deduction, not the amount of a tax.[7] The amount of the tax is set by § 143.071, and is 5 per cent for all corporations, including appellants. We do not believe appellants have established any breach of the constitutional provisions asserted.

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[6] This circumstance is not mentioned in the dissent.

[7] The dissent hypothesizes a situation where A and B are identical corporations, doing the same amount of business in Missouri, with A being a subsidiary of a group which filed a consolidated federal income tax return, while B is an independent corporation. It is further assumed that both A and B file separate Missouri returns, with both using federal taxable income as the basis for computing Missouri taxable income, but with only B being permitted to deduct the federal income tax liability as shown on the federal return. This, it is said, constitutes different standards for taxation of corporations within the said class.

The case put overlooks, however, that it is a deduction we are concerned with here and, under the case put, B corporation qualifies for the deduction; A does not. A has no federal income tax liability in the sense that B has. The fact that an affiliated group may elect not to file a Missouri consolidated income tax return under § 143.431. 3(1), thus leaving corporation A free to file a separate Missouri return, the same as corporation B, does not change the situation or enlarge the applicability of the deduction permitted by the Missouri statute, § 143.171. It frequently happens that one taxpayer qualifies for a deduction, or for a larger deduction, while another does not. This does not mean the statute is unfairly imposing a greater tax on one than on the other.

On the other hand, if we apply the rationale used in the dissent to the hypothetical there set forth, corporation A would be placed in a much better position than corporation B. This is what appellants seek in the case at bar. A, a subsidiary of a parent corporation, would be permitted to deduct on its Missouri return an amount never paid by it

As stated earlier, the director of revenue limited the deduction in question to a proportionate share of the actual federal tax liability of the group. In so doing the director in general used the same formula as set forth in 26 U.S.C. § 1552(a)(1), which is one of the four alternative methods provided by § 1552 to determine the amount of consolidated tax liability to be allocated to each member of the group in arriving at their respective earnings and profits.[8] The director applied the ratio of the member's separate federal taxable income tax to the sum of the separate federal taxable incomes of those members of the consolidated group having taxable income to the federal income tax liability of the consolidated group and also took into consideration investment credits and foreign tax credits, if any. This method in effect gives no regard to any losses suffered by members of the group in computing the federal taxable income for purposes of the first ratio in the formula, but such losses are taken into account in determining the federal tax liability of the consolidated group to which the first ratio is applied.

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in federal income tax, while B, an independent corporation, could deduct only the amount which it actually paid to the federal government. We see no indication that the legislature intended that any corporation could deduct taxes neither owed nor paid by it to the federal government.

[8] 26 U.S.C. § 1552, entitled "Earnings and Profits" is a part of Chapter 6 - Consolidated Returns, Internal Revenue Code, and provides:

> (a) General rule.- Pursuant to regulations prescribed ... the earnings and profits of each member of an affiliated group required to be included in a consolidated return for such group filed for a taxable year shall be determined by allocating the tax liability of the group for such year among the members of the group in accord with whatever of the following methods the group shall elect in its first consolidated return filed for such a taxable year:

In addition to the other attacks made on the decision of the director referred to earlier herein, appellant Banquet Foods, in No. 63706, contends what the director did amounts to the adoption of a rule or regulation without first complying with the requirements of the Administrative Procedure Act, Chapter 536, RSMo 1978.

However, the real issue here is over whether the various taxpayers are entitled to deduct from their Missouri taxable income what their federal income tax would have been had they filed individual, separate federal income tax returns - is this deduction

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(1) The tax liability shall be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.

(2) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member if computed on a separate return would bear to the total amount of the taxes for all members of the group so computed.

(3) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be allocated on the basis of the contribution of each member of the group to the consolidated taxable income of the group. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their tax liabilities determined on a separate return basis and their tax liabilities based on their contributions to the consolidated taxable income.

(4) The tax liability of the group shall be allocated in accord with any other method selected by the group with the approval of the Secretary.

(b) Failure to elect.- If no election is made in such first return, the tax liability shall be allocated among the several members of the group pursuant to the method prescribed in subsection (a)(1).

statutorily authorized? No claim is being made that if the director is correct in disallowing the deductions claimed by the appellants, they nonetheless also object to the deductions which were allowed. We need not go into the aspect of whether the director was correct in arriving at the proportionate deductions as he did if we are satisfied, as we are, that the appellants were not entitled to deduct whatever their respective federal income tax payments would have been had they filed separate federal returns. That question can await a case where it is directly presented.

The judgment is affirmed and the cause is remanded for entry of judgment together with whatever additional interest is determined to be due.

Robert E. Seiler, Senior Judge

Rendlen, C.J., Higgins, Gunn, Donnelly, JJ. and Dowd, Sp. J., concur; Welliver, J., dissents in separate opinion filed. Billings and Blackmar, JJ., not participating because not members of the Court when cause was submitted.

DISSENTING OPINION

I respectfully dissent.

Suppose that A and B are identical corporations. Each does the same amount of business in Missouri. A is a member of a group of corporations that files a consolidated federal income tax return, and B is not. B files a separate Missouri return, and A does the same because it does not meet the statutory criteria for filing a consolidated Missouri return. Section 143.431(1),

RSMo 1978,[1] requires corporations to use their federal taxable income as the basis for computing their Missouri taxable income. Section 143.431(3)(4) states that if a corporation files separately in Missouri but has no separate federal return, its federal taxable income shall be determined hypothetically as if it had filed a separate federal return. The basis for A's Missouri return thus would be what A's federal return would have been if A had filed as a separate entity rather than as a member of an affiliated group. The principal opinion holds that in this situation B may deduct for Missouri purposes the entire amount of federal income tax due on its separate federal return but that A may not do so. In other words, the principal opinion holds that both A and B must use a separate federal return as the basis for computing Missouri taxable income but that only B can use it for computing the Missouri deduction for federal income tax liability.

I fail to see any rational basis for this distinction. The statute requires corporations that cannot, or do not, file a consolidated Missouri return to use a separate federal income tax return, whether actual or hypothetical, as the basis for computing Missouri taxable income so that all such corporations are treated equally. Section 143.171, which provides the deduction for federal income tax liability, makes no distinction between an actual separate federal return and a hypothetical one. The use of a hypothetical separate federal return, like the use of an actual one, consequently must extend to all aspects of the computation of Missouri taxable income, including the determination of federal income tax liability that is based upon that return. To hold otherwise is to read into the statute a disparity that the statute itself is designed to avoid.

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[1] All statutory references are to RSMo 1978.

The principal opinion's argument regarding classification is unpersuasive. We do not deal here with a distinction between those corporations that may file consolidated returns in Missouri and those that may not. All corporations may file separately in Missouri, even if they are entitled to file consolidated state returns. *See* § 143.431(3)(1) We deal here with a difference in treatment among those corporations that file separately. That difference is based solely upon the fact that some of those corporations, such as appellants here and A in the example above, file as part of an affiliated group at the federal level. The apparent justification for this distinction is that a corporation somehow gains a benefit from being part of an affiliated group. That premise is not necessarily true, but whether it is true or not is immaterial. We are concerned with what happens at the state, and not the federal, level. Nothing empowers Missouri to impose a greater state income tax on a corporation that is part of an affiliated group simply because the federal tax liability of the group as a whole might happen to be less than that corporation's federal tax liability would have been had it filed separately.[2] There is no justification for employing two different standards for taxation of corporations within the same class. All corporations that file separate returns in Missouri should be treated equally.

The judgment of the circuit court should be reversed.

WARREN D. WELLIVER, Judge

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[2] Federal law provides that all members of an affiliated group of corporations filing a consolidated return shall be severally liable for the entire amount of tax assessed against the group as a whole. *See* 26 C.F.R. § 1.1502-6(a) (1982).

APPENDIX B

SUPREME COURT OF MISSOURI
EN BANC

No. 63348

Wells Aluminum, Inc.
Appellant,

v.

Administrative Hearing Commission,
Respondent.

PETITION FOR REVIEW OF ADMINISTRATIVE HEARING COMMISSION

We have jurisdiction of this review because it involves construction of the revenue laws and is here on a petition for review of a decision of respondent Administrative Hearing Commission. Mo. Const., art. V, § 3; § 161.337, RSMo 1978.

The case is a companion case to No. 63297, Mid-America Television Company and Oliver Advertising, Inc. v. State Tax Commission, decided this date, and involves the same questions as to the Missouri income tax deduction allowable under § 143.171, RSMo 1978 for federal income tax liability of a subsidiary or member corporation which participates in filing a consolidated federal income tax return but which files a separate Missouri income tax return.

Wells Aluminum, Inc. (Wells) is a member of a consolidated group of which Revere Copper and Brass, Incorporated is the parent. For the years in question, 1974, 1975, and 1976, Wells joined with the parent and other members of the affiliated group in filing a consolidated federal income tax return. The members of the consolidated group were not eligible to file a consolidated Missouri income tax return during the years in question and therefore Wells filed separate Missouri returns. In

preparing its Missouri corporate income tax returns, Wells computed its Missouri taxable income by allocating to Missouri that portion of its federal taxable income (computed as though a separate federal income tax return had been prepared) which was derived from Missouri sources. From the amount so computed Wells took a deduction equal to its federal tax liability, computed as though a separate federal income tax return had been filed. Pursuant to an agreement among the members of the group and in accordance with the financial accounting policy of the group pertaining to the allocation of federal income tax liability, Wells was obligated to and did pay the parent company an amount equal to the federal tax liability which would have been paid to the federal government had Wells filed a federal return on an individual basis.

The director of revenue disallowed Wells' proposed deduction and permitted only a proportionate share of the consolidated group's actual federal income tax liability, determined by multiplying the consolidated group's tax by the ratio of Wells' separate federal taxable income over the federal taxable income of the entire group.

Final notices of deficiency were issued by the director, together with interest to date of notice, as follows:

	Additional Tax	Interest
1974	$34,093	$7,329.99
1975	20,895	3,238.72
1976	32,829	3,118.75

The Director's decision was appealed to the Administrative Hearing Commission, which affirmed the decision of the director. A petition for review was then filed in this court.

The issues in this case are the same as those in No. 63297, Mid-America Television Company and Oliver Advertising, Inc. v. State Tax Commission, *supra*. What was said in that case ap-

plies equally here. The judgment is therefore affirmed and the cause is remanded for entry of judgment together with whatever additional interest is determined to be due.

Robert E. Seiler, Senior Judge

Rendlin, C.J., Higgins, Gunn, Donnelly, JJ. and Dowd, Sp. J., concur; Welliver, J., dissents in separate opinion filed. Billings and Blackmar, JJ., not participating because not members of the Court when cause was submitted.

DISSENTING OPINION

I respectfully dissent for the reasons stated in my dissenting opinion in Mid-America Television Co. v. State Tax Commission, ____S.W.2d____ (Mo. banc 1983) [No. 63297], decided herewith.

WARREN D. WELLIVER, Judge

APPENDIX C

CLERK OF THE SUPREME COURT
STATE OF MISSOURI
Post Office Box 150
Jefferson City, Missouri 65102

Thomas F. Simon
Clerk

Telephone
(314) 751-4144

June 30, 1983

Mr. Robert E. Zimmerman
Mr. Joe L. Anderson
Mr. Robert K. Dreiling
301 West 11th Street
Kansas City, MO 64105

In re: Mid-America Television Company, et al. vs. State Tax Commission of Missouri, et al., No. 63297

Gentlemen:

This is to advise that the Court this day entered the following order in the above-entitled cause:

"Apps.' motion for rehearing overruled."

Very truly yours,

/s/ Thomas F. Simon
Clerk

cc: Attorney General

APPENDIX D

CLERK OF THE SUPREME COURT
STATE OF MISSOURI
Post Office Box 150
Jefferson City, Missouri 65102

Thomas F. Simon
Clerk

Telephone
(314) 751-4144

June 30, 1983

Mr. James W. Kapp, Jr.
1000 Power & Light Bldg.
106 West 14th St.
Kansas City, MO 64105

In re: Wells Aluminum, Inc. vs. Administrative Hearing Commission, No. 63348

Dear Mr. Kapp:

This is to advise that the Court this day entered the following order in the above-entitled cause:

"App.'s motion for rehearing overruled."

Very truly yours,

/s/ Thomas F. Simon
Clerk

cc: Attorney General
Jerry W. Venters

APPENDIX E

STATE TAX COMMISSION OF MISSOURI

Appeals Number 1976-41 and 1976-51

Mid-America Television Company, Oliver Advertising, Inc.,
Complainants,

v.

Gerald H. Goldberg, Director of Revenue
for the State of Missouri,
Respondent.

DECISION AND ORDER

I. Findings of Fact

The State Tax Commission of Missouri, having considered all of the competent evidence upon the whole record, makes the following Findings of Fact:

1.1 The Complainants in the above-numbered appeals are Mid-America Television Company and Oliver Advertising, Inc.

1.2 The Respondent in the above-numbered appeals is Gerald H. Goldberg, in his official capacity as Director of Revenue for the State of Missouri.

1.3 An evidentiary hearing was held on April 21, 1977, in the County of Cole. The Complainant appeared by counsel, Robert K. Dreiling. The Respondent appeared by counsel, William N. Heckel, Assistant General Counsel, Department of Revenue, and J. Michael Davis, Asistant Attorney General.

1.4 Complainant timely filed its notice of appeal with the Commission on December 9, 1976, pursuant to Sections 138.430, and 143.260, RSMo 1969.

1.5 The primary issue herein presented is the Federal Income Tax liability under Chapter 1 of the Internal Revenue Code for the year 1973 of each Complainant.

1.6 Complainants in the above-numbered appeals are subsidiaries of Kansas City Southern Industries.

1.7 Neither Complainant filed a separate income tax return for 1973.

1.8 Complainants Mid America Television Company and Oliver Advertising, Inc., are members of an affiliated group of corporations and were incorporated in the 1973 consolidated income tax return of Kansas City Southern Industries, Inc., and affiliated companies.

1.9 Complainants were profit members of the consolidated group. The parent corporation, Kansas City Southern Industries, Inc., made a hypothetical computation for each Complainant of what its Federal Income Tax liability would have been if it had filed a separate company return.

1.10 Within the group, payments were made by the profit members to the parent corporation in the amount of the Federal Income Tax computed by the corporation to have been the profit members liability under Chapter 1 of the Internal Revenue Code if the profit members had filed on a separate basis.

1.11 For the tax year 1973, Complainant Oliver Advertising, Inc., paid $50,491.00 to the parent corporation as a result of the above computation, and claimed the same amount as a deduction on its Missouri Corporation Income Tax Return.

1.12 Complainant Mid-America Television Co., paid $63,531.00 as a result of the above-referenced computation as what its hypothetical Federal Income Tax liabiity would have been had it filed on a separate basis.

1.13 The affiliated group paid Federal Income Tax for the year 1973 in the amount of $14,933.00.

1.14 Neither Complainant paid any Federal Income Tax to the Federal government on a liability of its own.

1.15 The only assessment for income tax liability made against these Complainants as separate companies was that made by the parent (Tr. 53).

1.16 The Kansas City Southern Industries affiliated group did not file a Missouri consolidated income tax return under the provisions of Section 143.431, RSMo 1969 for the tax year 1973.

1.17 Both Complainants filed separate corporate income tax returns for the tax years in question.

1.18 On the 23rd day of April 1980, the Commission convened in a regular public meeting to consider and rule upon the said appeals.

II. Conclusions of Law

The State Tax Commission of Missouri finds the law as it applies to these appeals to be as follows:

2.1 The Commission has jurisdiction to hear these appeals. Article X, Section 14, Missouri Constitution of 1945; Section 138.430(1), RSMo 1969.

2.2 The decision of the Commission must be based upon, and only upon, its examination of all testimony and records received onto evidence upon the record. Article V, Section 18; Sections 138.310(2), 138.470(1), 536.070(8), 536.140(2)(3); Koplar v. State Tax Commission, 321 S.W.2d 686, 695 (Mo. 1959). *See* Missouri Church of Scientology v. State Tax Commission, 560 S.W.2d 837, 839 (Mo. banc 1977).

2.3 The income taxation statutes in Missouri do not, by their classification provisions, violate the due process clause of the Federal Constitution. Stouffer v. Crawford, 322 Mo. 161, 248 S.W. 581, 585 (1923); Ludlow-Saylor Wire Co. v. Wollbrinck, 275 Mo. 339, 205 S.W. 196, 197-198 (banc 1918).

2.4 Missouri law may impose a tax on or measured by income which may be defined by reference to provisions of the laws of the United States. Article X, Section 4(d).

2.5 The legislature may classify taxpayers for purposes of income taxation upon the reasonable basis of their legal organization, or the amount of their income, or the source of their income. Stouffer v. Crawford, 322 Mo. 161, 248 S.W. 581, 585 (1923); Ludlow-Saylor Wire Co. v. Wollbrinck, 275 Mo. 339, 205 S.W. 196, 200 (banc 1918).

2.6 "Taxable income" means that income which may be taxed after all exemptions and deductions have been allowed from the total income. State ex rel. Buder v. Hackmann, 305 Mo. 342, 265 S.W. 532, 535 (banc 1924).

2.7 The pertinent language of Section 143.171(1), RSMo 1978, reads as follows:

> From said income shall be deducted . . . such portion of taxes on income assessed by the United States against the taxpayer . . . .

2.8 The material portion of Section 143.171(1), RSMo 1978, states,

> A taxpayer shall be allowed a deduction for his *Federal Income Tax liability under Chapter 1* of the Internal Revenue Code [for the same tax year].

2.9 An affiliated group of corporations may exercise the privilage of filing a consolidated return under Chapter 6 of the Internal Revenue Code. This privilage is exercised with respect to the income tax imposed by *Chapter 1* of the Code. 26 U.S.C. Section 1501.

2.10 The primary rule of statutory construction is to ascertain the legislative intent. Missourians for Honest Elections v. Missouri Elections Commission, 536 S.W.2d 766, 772 (Mo. App. 1976).

2.11 "The interpretation and construction of a statute by an agency charged with its administration is entitled to great weight." Foremost-McKesson, Inc. v. Davis, 488 S.W.2d 193, 197 (Mo. banc 1972).

2.12 "Administrative construction . . . . cannot prevail upon the plain language of the statute." In re Kansas City Star Co., 346 Mo. 658, 142 S.W.2d 1029, 1035 (banc 1940).

2.13 "Administration bodies are not ordinarily bound by their prior determinations or the principles or policies on which they are based." Mitchell v. City of Springfield, 410 S.W.2d 585, 589-590 (Mo. App. 1966).

2.14 Filing a consolidated return is privileged and results in a consolidated tax liability. State v. Western Grain Co., 318 S.2d 719, 722 (Ala. Supp. Ct. 1975).

2.15 Deductions for income tax purposes are a matter of legislative grace. The taxpayer bears the burden of showing that he comes within one of the deductions. Mobil Oil Corporation v. State Tax Commission, 513 S.W.2d 319, 322 (Mo. 1974).

2.16 An income tax is imposed for each taxable year on the taxable income of every corporation by 26 U.S.C. Section 11(a).

2.17 Missouri imposes an income tax on every corporation taxable under Sections 143.011 to 143.996, RSMo 1978.

III. Decisions

The State Tax Commission of Missouri, being fully advised in the matters and upon full consideration thereof, makes the following decisions in these appeals:

3.1 Complainants contend that they should be permitted to deduct from Missouri income that amount of Federal Tax that they would have been liable for if they had filed on a separate return basis rather than joining in a consolidated return with the Kansas City Southern Industries, Inc., afiliated group. The Commission disagrees.

Section 143.171, RSMo 1978, allows a deduction only for the Federal Income Tax liability imposed under Chapter 1 of the Internal Revenue Code. Complainant has opted to determine its Chapter 1 liability for Federal Income taxes under the provisions of Chapter 6 of the Internal Revenue Code. Chapter 6 allows the privilege of consolidated returns for certain "affiliated groups". The Commission finds that Section 1501 of Subchapter A of Chapter 6 of the Internal Revenue Code supplies merely a method of computing the "Federal Income Tax Liability under chapter 1." This affiliated group's income tax liability under Chapter 1 was $14,933.00. Complainant Mid-America Television Co. seeks a deduction of $63,531.00, and Complainant Oliver Advertising, Inc. desire a deduction of $50,491.00. As is readily apparent upon a consideration of the language of Section 143.171. supra, the liability of these two Complainants could be no greater than the liability of the affiliated group as a whole. Therefore, Complainants would be entitled to deduct only their proportionate share of the actual income tax liability of the group. Respondent correctly assessed additional taxes for the year 1973.

IV. ORDER

Based upon the foregoing, it is hereby ORDERED, ADJUDGED AND DECREED by the State Tax Commission of Missouri as follows:

4.1 The Decision of the Director of Revenue, shall be, and the same is hereby AFFIRMED.

4.2 Any Finding of Fact which is a Conclusion of Law or Decision shall be so deemed. Any Decision which is a finding of Fact or Conclusion of Law shall be so deemed.

4.3 The Administrative Secretary of the Commission shall serve a certified copy of this Decision and Order upon each party to these appeals.

4.4 This Decision and Order shall become effective on the 23rd day of April, 1980.

STATE TAX COMMISSION OF MISSOURI

Chairman

Commissioner

Commissioner

Dated at Jefferson City, Missouri,
on this 23rd day of April, 1980.

STATE TAX COMMISSION OF MISSOURI

Certification

I, ROBERT COLEMAN, being the duly appointed Administrative Secretary of the State Tax Commission of Missouri, hereby certify the aforegoing Decision and Order in Appeals Number 1976-41 and 1976-51 to be a true copy of the proceedings of said Commission as the same appears on record in my office, and further certify that a true copy of the aforegoing has been personally delivered or mailed postage prepaid to the following:

Robert K. Dreiling, Esq.
Kansas City Southern Industries, Inc.
114 West Eleventh St.
Kansas City, Missouri 64105

Deborah Kerns
Associate General Counsel
Department of Revenue
Jefferson City, Missouri 65101

Richard L. Wieler, Esq.
Assistant Attorney General
P.O. Box 899
Jefferson City, Missouri 65102

WITNESS MY HAND AND THE SEAL OF SAID COMMISSION ON THIS 23rd DAY OF April, 1980.

BY ROBERT COLEMAN
Administrative Secretary

APPENDIX F

IN THE CIRCUIT COURT OF JACKSON COUNTY, MISSOURI

No. CV80-11478
Civil Docket F

Mid-America Television Company,
and
Oliver Advertising, Inc.,
Petitioners,

v.

State Tax Commission of Missouri; and
Dennis K. Hoffert, Chairman; and
Stephen C. Snyder, Commissioner,
Respondents.

MEMORANDUM OPINION AND JUDGMENT

Plaintiff corporations, subsidiaries of Kansas City Southern Industries, Inc., have appealed decision of the State Tax Commission, which affirmed the prior decision of the Director of Revenue and disallowed claimed deductions.

For reasons hereinafter briefly noted the decision of the Commission must be affirmed and the deductions disallowed.

There appears to be no factual dispute. Rather the dispute revolves about the right of the taxpayers to claim as deductions amounts equal to their respective federal income tax liabilities *as if* they had filed separate federal income tax returns and equal to the amounts they had in fact paid to their parent corporation as their respective portions of tax liability disclosed by a consolidated federal corporate income tax return.

The word "liability" in the above paragraph is used somewhat loosely. It is believed that a similar inexactness is found in the 1972 amendment to Chapter 143 of RSMo 1968. The teaching of Armco Steel Corp. v. State Tax Commission, 580 S.W.2d 242 (Mo.banc 1979) is that the statute must be construed as written, not as "economic realities" might suggest or as a court might think a better approach to the problem. *Jus dicere non dare.*

Then there is a matter of 5th grade arithmetic:

$$\begin{array}{r} \$\ 50{,}491 \\ 63{,}531 \\ \hline \$114{,}022 \end{array}$$

The sum of the claimed deductions is substantially different from the total federal tax of the affiliated group, $14,933.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that the Decision and Order of the Commission dated April 23, 1980, be and is hereby AFFIRMED, all at plaintiffs' cost.

James A. Moore,
Senior Judge

July 22, 1981

cc. Mr. Robert K. Dreiling
Mr. Michael Scearce

APPENDIX G

MISSOURI DEPARTMENT OF REVENUE

In the Matter of Wells Aluminum, Incorporated

Protest of Final Notice of Deficiency

Corporation Income Tax

1974, 1975 and 1976

FINAL DECISION UPON RECONSIDERATION

FINDINGS OF FACT

Wells Aluminum, Inc., is a Missouri corporation. It is a member of a consolidated group, of which Revere Copper and Brass, Inc. is the parent, and reports its federal income tax liability pursuant to a consolidated return filed by the parent corporation. In preparing its Missouri income tax return for each of the years in question, the Taxpayer computed its federal taxable income as if it had filed a separate federal return and determined the federal income tax which would be due thereon. For each such year, the Taxpayer reported as its Missouri income that portion of its federal taxable income computed as if a separate return were filed for federal purposes which was derived from sources within Missouri and deducted therefrom that percentage of the federal income tax liability that it would have incurred had it filed a separate return for federal purposes which its Missouri taxable income bore to its federal taxable income. On November 1, 1978 the Department of Revenue issued notices of corporate income tax deficiencies against the Taxpayer as follows:

YEAR	ADDITIONAL TAX	INTEREST	TOTAL
1974	$34,093.00	$7,329.99	$41,422.99
1975	20,895.00	3,238.72	24,133.72
1976	32,829.00	3,118.75	35,947.75

The deficiencies issued are primarily due to the disallowance of the deduction for federal income taxes. The principal issue with respect to the federal income tax deduction is the method by which a corporation which is a member of a consolidated group for federal purposes may compute the deduction for federal income taxes. The Taypayer does not protest or request an abatement or correction of that portion of the assessments relating to the allocation of additional net income to Missouri for the following years and in the following amounts:

1974	$21,568.00
1975	$ 8,264.78
1976	$13,561.00

subject, however, to Taxpayer's claimed adjustment by way of deduction for the federal income tax attributable to said additional net income.

The federal income tax deduction was disallowed by the Department of Revenue in accordance with its position that only the actual federal income tax liability of the consolidated group is to be apportioned to determine the proper federal income tax deduction for Missouri purposes. The Department of Revenue apportions that actual liability in accordance with the method prescribed by IRC §1552.

The consolidated group of which the Taxpayer is a member had no federal consolidated taxable income for the years here at issue and thus no federal income tax was paid by the consolidated group for any of the years here at issue.

There being no consolidated group federal income tax liability, no deduction for federal income tax liability was allowed on the Missouri return.

DISCUSSION

On each of the separate corporate income tax returns the Taxpayer filed for the taxable years at issue. The Taxpayer computed the federal income tax deduction on a hypothetical basis. Taxpayer computed the federal income tax liability it *would have incurred* had it filed for federal purposes as a separate corporate entity.

Section 143.171.1, RSMo., Supp. 1975 provides that:

> "A taxpayer shall be allowed a deduction for his federal income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed...."

It can be reasonably ascertained that the intent of the Missouri legislature in providing such a deduction was to allow a deduction for amounts incurred as a federal income liability. No problem is presented in applying this statute when Taxpayer's file their federal returns as a separate entity, however in this case the Taxpayer was a member of a consolidated group which filed a federal consolidated income tax return.

Section 143.961, RSMo., 1975, paragraph 2 provides:

> "The rules and regulations prescribed by the director of revenue shall follow as nearly as practicable the rules and regulations of the secretary of the treasury of the United States or his delegate regarding income taxation. Such construction of sections 143.011 to 143.996 will further their purposes to simplify the preparation of income tax returns, aid in their interpretation through use of federal precedents, and improve its inforcement."

Although the Department of Revenue's policy to allocate the federal income tax liability of a consolidated group in accordance with that method prescribed by Section 1552 of the Inter-

nal Revenue Code has not been promulgated in a rule or regulation, it has been, since the inception of the new income tax law in 1973, the administrative practice of the Department of Revenue. Certainly the use of a single method which is utilized by the Internal Revenue Code to determine the federal income tax deduction accomplishes the purposes of this law, that is, "...to simplify the preparation of income tax returns, aid in its interpretation through use of federal precedents, and improve its inforcement."

Section 143.171, RSMo., Supp. 1975 does not state, either directly or implicitly, that the deduction must be based upon what federal income tax liability would have been incurred if Taxpayer had filed a separate return based on its own Missouri income. The word liability as used in this statute could not mean the amount or rate that *could be* incurred as a liability against the Missouri corporate entity but, to the contrary, could and does mean the tax liability *actually* incurred by the taxpayer.

There are several cases decided in the courts of other states construing statutory provisions allowing a federal income tax deduction. The statutes involved in these cases refer to taxes either "paid" or "accrued" rather than "liability" as in the Missouri statute. See *Standard Oil Company* v. *State,* 55 Ala. App. 103, 313 So.2d 532 (Ala. 1975); *Northern Natural Gas* v. *Commissioner of Revenue,* 251 N.W.2d 125, 129 (S.Ct. Minn. 1977); *Buick Motor Company* v. *City of Milwaukee,* 48 Fed.2d 801 (Ct. App. 7th Cir. 1931), cert. denied, 284 U.S. 655, 52 S.Ct. 34, 76 L.Ed. 556; *State* v. *Western Grain Company,* 318 So.2d 719, cert. denied, 294 Ala. _____, 318 So.2d 722 (S.Ct. 1975).

In *Standard Oil Company* v. *State, supra,* Kyso, a wholly owned subsidiary of Socal, sought to deduct, for state income tax purposes, money paid to the parent corporation rather than a percentage of the actual amount of cash paid by Socal to the IRS. Alabama's policy was to allow Kyso a deduction only for

the federal income tax actually paid in cash by Socal and attributable to Kyso. The Alabama court held that payment by Kyso to Socal did not amount to federal income taxes which were actually "paid or accrued" by Kyso and that Kyso's Alabama income tax deduction could only be based upon a proportionate amount of Socal's taxes actually paid to the Federal government. Essentially the same result was reached in the *Northern Natural Gas* v. *Commissioner of Revenue* case, *supra.*

The Department of Revenue takes the position that the language "federal income tax liability" is not of such different meaning than the words "paid or accrued" to allow for making a distinction. The word "liability" is defined in Ballentine's Law Dictionary, 3rd Edition, as "...legal responsibility, either civil or criminal. The condition of being bound in law and justice to pay an indebtness or discharge some obligation." It goes on to say that the word is "...sometimes synonymous with debt."

It is clear that Taxpayer in this case has not incurred a liability to the federal government in the amount it claims as its federal income tax deduction in this case. The only actual liability it incurred was its proportionate share of the amount of federal income tax liability incurred by the consolidated group.

Taxpayer cites *Armco Steel Corp.* v. *State Tax Commission of Missouri,* 768046, a decision of the circuit court of Jackson County rendered on November 3, 1977. Taxpayer readily admits that this case involved issues very similar to those in the case at hand.

On March 13, 1979, the Supreme Court of Missouri, en banc, handed down its decision on appeal from the circuit court of Jackson County in the *Armco Steel Corp.* case. That opinion was modified on the court's own motion on April 10, 1979. The decision of the Supreme Court reversed the decision of the circuit court of Jackson County. As the court stated:

"...We find the reasoning followed in cases holding that only the amount of federal taxes actually paid may be deducted more persuasive. (Citations omitted.) These cases considered and rejected arguments similar to *Armco's. Armco* seems to distinguish them on the basis that they concern statutes which refer to 'taxes paid' rather than 'taxes assessed', and that the courts were influenced by state regulations supporting the result reached. While differences in the language of statutes in all cases require that each be considered on its own facts, we note that 'to assess a tax is to declare a tax to be payable', *Valley* v. *Fargo,* 1 Mo. App. 344 (1876), from which it would follow that the taxes paid would presumably be the taxes assessed. Moreover, even if we accept *Armco's* primary definition of assessed as 'to determine the rate or amount of' the amount 'assessed' must be the rate or amount actually determined, not the rate or amount which would have been determined had a separate federal return been filed.

Thus, we conclude that regardless that *Armco* expended an amount equal to what it would have expended had it filed a separate federal return, it was not assessed that amount. Section 143.040 is not designed to permit a corporation to deduct any expense which it may have occurred as a result of having filed a consolidated federal return, but only to permit it to deduct the actual assessment made against it in order to arrive at a more accurate approximation of its net income from Missouri business activities. Whatever the business reason for the affiliates joining in the consolidated return, the payments *Armco* made to its affiliates still remained merely exchanges between affiliated corporations and not taxes assessed by or paid to the federal government.

This can perhaps best be illustrated by the following from Bittker and Eustice, Federal Income Taxation of Corporations and Shareholders, 15 (3d ed. 1971), which

notes that the basic concept underlying the consolidated return provisions of the Internal Revenue Code:

> 'is that the consolidated group constitutes, in substance, a single taxable enterprise, despite the existence of technically distinct entities; as such, its tax liability ought to be based on its dealings with 'ousiders,' rather than on intra-group transactions. This 'single taxpayer' concept lies at the heart of the treatment, both past and present, of intercompany transactions which, in general, are eliminated in computing the group's consolidated taxable income.'

As Bittker and Eustice go on to note, '[i]n effect, the results [of filing a consolidated return] are not unlike the 'joint return' treatment of husband and wife.' *Id.* It is of course appropriate for a husband and wife to take advantage of any benefits which will accrue to them by filing a joint rather than individual returns, just as it is appropriate for *Armco* to utilize the consolidated federal return if to do so will work to its advantage. However, while a husband, who made a profit, may thus file a joint federal return with his wife, who incurred a loss, and thereby reduce their joint federal tax liability, this would afford no justification for the husband then to file an individual Missouri return and claim a right to a federal tax deduction of what his federal tax would have been had he filed an individual federal return. This would be so regardless of the fact that he paid his wife any federal tax savings he realized by her inclusion in the joint return. Such payments would be intra-family exchanges, and could not affect the amount of tax liability which was actually assessed on the federal return or which could be legally deducted on his Missouri return. While of course federal consolidated return provisions are quite complex, and intra-group payments must be taken into account for some purposes, such as the computation of earnings and profits, in a different manner

than would be true of intra-family payments, the basic analogy holds."

Thus, the Supreme Court of Missouri held that under the Missouri income tax law existing prior to January 1, 1973 the deduction for federal income taxes on the basis of what liability would have been incurred had a separate federal return been filed was not proper and not allowable. The court's rationale in the decision is equally compelling under the new Missouri income tax law effective January 1, 1973.

Taxpayer cites Section 143.431.3(4), RSMo., 1975 Supp. as authority for the proposition that under the new income tax law a hypothetical federal income tax deduction based on the liability that would have been incurred had the taxpayer filed a separate federal corporate income tax return is now allowed.

Under the new Missouri income law "federal taxable income" as shown on the federal return is the starting point for determining the Missouri taxable income of a corporation. See Section 143.431.1, RSMo. Supp. 1975. Since an affiliated group of corporations filing a federal consolidated income tax return reports a consolidated federal taxable income of the group and not the "federal taxable incomes" of its separate members, Section 143.431.3(4) requires such member of that group which is required to file a separate Missouri corporate income return to determine its "federal taxable income" as if it had filed a separate federal income tax return.

At that point, Section 143.431.2, RSMo., 1975, Supp. allows each corporation to subtract from its "federal taxable income" the federal income tax deduction provided in Section 143.171.

Thus, Section 143.431.3(4), RSMo., Supp. 1975 has nothing to do with the determination of the amount of the federal income tax deduction but only with the determination of Missouri taxable income, the starting point from which deductions will be taken. As a practical matter there has been no change with

regard to this starting point when a Missouri corporate taxpayer is a member of a consolidated group for federal purposes but files a separate Missouri return. Although there was no specific mention under the old law of how to determine the Missouri taxable income of a member of a consolidated group for federal purposes, the income and expenses of such a corporation always were separately determined under the old Missouri income tax law.

Thus we must look to other provisions of the new Chapter 143 for guidance.

Although the language of Section 143.171, RSMo, Supp. 1975 is admittedly different from that of Section 143.040.1, RSMo., 1969 it does not authorize deductions to be taken on the basis of a hypothetical calculation for federal income tax.

The 1972 revision of the Missouri Income Tax Law made several significant departures from the language of the prior law. For example, the computation of the Missouri income tax now begins with "federal taxable income" rather than *a separate* determination of Missouri income and expenses and a deduction is now allowed for the "federal income tax *liability*" whereas before the deduction was for "taxes on income assessed" by the United States. Under the old law, the taxpayer would, for Missouri purposes, deduct additional federal income taxes assessed in the year in which they were assessed and not in the year in which the income upon which the tax was assessed was earned. Under the new income tax law, the use of the word "liability" forces the taxpayer to accrue any federal income taxes, that is, take a deduction for taxes assessed and paid in the year in which the income upon which the taxes are assessed was earned. (For an example of this issue see *Beech Aircraft Corp.* v. *State Commission of Revenue and Taxation*, 177 Kan. 754, 282 P.2d 432 (1955).)

Thus, although there are changes in Section 143.171, RSMo., Supp. 1975, that change was for the purpose of changing the

timing of the deduction and not for the purpose of affecting the issue at hand. The "liability" that may be deducted is still an *actual* liability and not a hypothetical liability as taxpayer proposes.

Further changes were made when the new Missouri income tax law was enacted which indicate a different method of determining the proper federal income tax deduction of a corporation which derives only part of its income from sources within Missouri. However, as will be shown, this change indicates only a different method of determining what proportion of the *actual* liability of the corporation may be deducted and further indicates that it is still a *proportionate part of this actual liability* and not a hypothetical liability which is authorized by statute.

Under Section 143.040.1, RSMo., 1969 the old income tax law allowed a deduction for "...such portion of taxes on income assessed by the United States against the taxpayer as *the gross income from all sources within this state shall bear to the gross income of the corporation from all sources.*" (Emphasis supplied.)

Under Section 143.451.8, RSMo. Supp. 1975 the new income tax law provides a different method yet it is fundamentally the same in that it allows a deduction only for a proportionate amount of federal income tax liability. This section provides:

> "If a corporation derives only part of its income from sources within Missouri, its Missouri taxable income shall only reflect the effect of the following listed deductions to the extent applicable to Missouri. The deductions are: (a) its deduction for federal income tax pursuant to section 143.171, and (b) the effect on Missouri taxable income of the deduction for net operating loss allowed by Section 172 of the Internal Revenue Code. *The extent applicable to Missouri shall be determined by multiplying the amount that would otherwise affect Missouri taxable income by the ratio for the year of the Missouri taxable income of the*

corporation for the year divided by the Missouri taxable income for the year as thought the corporation had derived all of its income from sources within Missouri. For the purpose of the preceding sentence, Missouri taxable income shall not reflect the listed deductions." (Emphasis supplied.)

In essence, the change is one which determines the proportion of the federal income tax liability in accordance with a net income to net income ratio as opposed to a gross income to gross income ratio.

Section 143.431.3(5), RSMo., Supp. 1975, makes the determination of the federal income tax deduction of a member of a consolidated group for federal purposes a discretionary act on the part of the Director of Revenue. In exercising that discretion under the new Missouri Income Tax Law the Director of Revenue has allowed a deduction determined under the method of allocation provided in IRC §1552. That method is consistent with a net income to net income allocation of federal income tax liability. The Director of Revenue has exercised his discretion reasonably and not arbitrarily in prescribing the method utilized by IRC §1552. Absent unreasonable or arbitrary exercise of this discretion the action of the Director of Revenue should not be overturned.

In addition, there is a well known canon of statutory construction that a deduction is a matter of legislative grace and the burden is upon the taxpayer to show that he clearly comes within its terms. *Mobil Oil Corp.* v. *State Tax Commission of Missouri,* 513 s.W.3d 319, 322-323 (Mo. Div. 2, 1974).

CONCLUSION

It is the final decision of the Director of Revenue that the notices of deficiency issued as outstanding against Wells Aluminum, Incorporated for additional Missouri corporate income tax for the taxable years 1974, 1975 and 1976 are correct.

If Taxpayer is dissatisfied with this reconsideration and final decision in any respect, it may appeal to the Administrative Hearing Commission as provided in Section 143.651, RSMo., as amended by Senate Bill 661, 79th General Assembly effective August 13, 1978.

William C. Harrelson
Hearing Officer

Dated: 5-9-79

APPENDIX H

BEFORE THE ADMINISTRATIVE
HEARING COMMISSION OF MISSOURI

Case No. R-79145

Wells Aluminum, Inc.,
Petitioner,

v.

Director of Revenue for the
State of Missouri,
Respondent.

STIPULATION

It is hereby stipulated that, for the purposes of this appeal, the following statements may be accepted as facts and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof for the Commission's review.

1. Wells Aluminum, Inc., is the Petitioner in this appeal, (herein called "Wells") and is a corporation organized under the laws of the State of Missouri with its principal business office at 808 County Road, Monett, Missouri 65708.

2. Wells was a member of a consolidated group of which Revere Copper and Brass, Incorporated is the parent, (herein called the "Parent Company") for the taxable years ended December 31, 1974, 1975 and 1976 and joined with the Parent Conpany and the other members of the consolidated group in the filing of Federal consolidated income tax returns in those years. The members of the consolidated group were not eligible to file a consolidated Missouri income tax return during such years and therefore Wells filed a separate Missouri income tax return.

3. Copies of Wells' 1974, 1975 and 1976 Missouri corporate income tax returns are attached hereto as Exhibits A, B and C, respectively. Such returns were duly and timely filed with the Missouri Department of Revenue. The aforesaid Exhibits are to be incorporated into this Stipulation and taken as mathematically correct. Wells has duly paid the full amount of Missouri corporate income tax as reflected on such returns.

4. The Director of Revenue of Missouri issued a notice of deficiency dated November 1, 1978 for each of the years 1974, 1975 and 1976.

5. The final notices of state income tax deficiencies issued to Wells for the years 1974, 1975 and 1976 are attached hereto as Exhibits D, E and F, respectively. Such final notices of state income tax deficiencies are to be incorporated into this stipulation and taken as mathematically correct. The Audit Report compiled by the Department of Revenue of Missouri concerning the books of Wells which gave rise to the Director of Revenue's final notice of state income tax deficiency and the appeal to this Commission, is attached hereto as Exhibit G, is to be incorporated into this Stipulation and taken as mathematically correct. The auditor(s) who conducted the audit of Wells were (are) duly appointed auditors of the Department of Revenue of Missouri qualified to conduct the audit incorporated herein. The figures contained in the Audit Report are an accurate reflection of the figures contained in Wells' books and records.

The final notices of deficiency issued by the Missouri Department of Revenue asserted corporate income tax deficiencies during each of the years in question as indicated below, together with interest to the date of the final notice of deficiency:

	Additional Tax	**Interest**
1974	$34,093	$7,329.99
1975	20,895	3,238.72
1976	32,829	3,118.75

6. Wells timely filed a protest letter with the Department of Revenue against the assessments set forth in the final notices of deficiency for the years 1974, 1975 and 1976.

7. The Director of Revenue issued his Final Decision Upon Reconsideration dated May 9, 1979, which upheld the notices of deficiency for each of the years in question and denied the protest filed by Wells.

8. Wells filed a Complaint with this Commission on June 7, 1979, appealing the Director's Final Decision Upon Reconsideration and the assessments set forth in the notices of deficiency. The Appeal was duly and timely filed with this Commission and is properly before this Commission.

9. The aforementioned alleged deficiencies during each of the years in question are primarily due to the recomputation of the deduction for Federal income tax liability. Wells does not appeal or request an abatement or correction of that portion of the deficiency assessment of the Department of Revenue relating to the different apportionment percentage for income attributable to Missouri for each of the years 1974, 1975 and 1976. Accordingly, Wells agrees that its Missouri taxable income should be increased in the amount of $21,568 for 1974, in the amount of $8,264.78 for 1975, and in the amount of $13,561 for 1976, subject, however, to appropriate adjustments by way of deductions for the Federal income tax, if any, attributable to said additional net income.

10. In preparing its Missouri corporate income tax returns for each of the years 1974, 1975 and 1976, Wells reported as its Missouri income that portion of its Federal taxable income, computed as if a separate Federal income tax return was filed, which was derived from sources within Missouri. Wells took as a Federal income tax deduction the Federal income tax liability determined on a separate return basis (using the maximum statutory rate, less the investment tax credit) and applying thereto the ratio of its Missouri income to its total gross income

pursuant to the following formula: The Missouri income percentage calculated pursuant to Section 143.415.2(a) X Federal Income Tax Liability of Wells determined on a Separate Return Basis.

11. Pursuant to an agreement among the various members of the consolidated group and financial accounting policy of the group pertaining to the allocation of Federal income tax liability, Wells was obligated to pay the Parent Company an amount representing its federal tax liability computed on its separate income. Accordingly, Wells consistently paid to the Parent Company during the years in question the amount it determined as its Federal income tax liability on a separate company basis. The aforesaid amounts paid by Wells to the Parent Company each year were somewhat larger than the amount used in making the computation for the Missouri return. This occurs because certain deductions (primarily accelerated depreciation) are taken for return purposes that are not taken by the members in computing income for financial accounting purposes. The Parent Company made no election pursuant to Section 1552 of the Internal Revenue Code or the regulations thereunder regarding a method of adjusting earnings and profits for Federal income tax purposes.

12. In issuing the aforesaid final notices of state income tax deficiencies, the Director of Revenue of Missouri took the position that Wells' deduction for Federal income tax will be limited to deducting a proportionate part of the consolidated Federal income tax liability as shown on the consolidated return of the Parent Corporation. The Director of Revenue computed Wells' Federal income tax deduction pursuant to Section 1552(a)(1) of the Internal Revenue Code and Regulation Section 1.1552-1 (a) (1) promulgated thereunder by applying the ratio of Wells' separate Federal taxable income to the sum of the consolidated group having taxable income to the Federal income tax liability of the consolidated group (after all credits but before investment credit recapture) plus Wells' separate return investment credit recapture and foreign tax credits as follows:

$$\frac{\text{Wells' Separate Federal Taxable Income}}{\text{Sum of the Separate Federal Taxable Incomes Attributable to Each Member of the Group Having Taxable Income}} \times \text{Federal Tax Paid by Consolidated Group (after all credits but before investment credit recapture)} + \text{Wells' Separate Return Investment Credit Recapture and Foreign Tax Credit}$$

Such method in effect gives no regard to any losses suffered by members of the group in computing the federal taxable income for purposes of the first ratio in the above formula, but such losses are taken into account in determining the Federal tax liability of the consolidated group to which the first ratio above is applied.

WHEREFORE, the parties hereto respectfully submit the foregoing Stipulation.

WILLIAM C. HARRELSON
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Attorney for Respondent

DATE: February 8, 1980

SPENCER, FANE, BRITT & BROWNE

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Attorneys for Petitioner

DATE: February 7, 1980

APPENDIX I

BEFORE THE
ADMINISTRATIVE HEARING COMMISSION
STATE OF MISSOURI

Case Nos. R-79145
R-79304

Wells Aluminum, Inc.
808 County Road
Monett, Missouri 65708
Petitioner,

v.

Director of Revenue
P.O. Box 475
Jefferson City, Missouri
65105

STATEMENT OF THE CASE, FINDINGS OF FACT CONCLUSIONS OF LAW AND DECISION

Statement of the Case

Wells Aluminum, Inc., Petitioner, is appealing the final decision of the Director of Revenue, Respondent, concerning alleged income tax deficiencies for the years 1973, 1974, 1975 and 1976. Two separate complaints were brought: One appealing Respondent's final decision for the year 1973 and one appealing Respondent's final decision for 1974, 1975 and 1976. Because both complaints involve the same issues, they were consolidated by Order of the Commission, dated September 5, 1980, for the purpose of issuing a decision. Petitioner was represented by counsel, Mr. James W. Kapp, Jr., and Mr. Max H. Bergman. Respondent was represented by Mr. William C. Harrelson and Ms. Deborah J. Kerns, Associate General Counsels, Missouri Department of Revenue.

The parties have submitted this matter to the Commission upon a Joint Stipulation of Facts. Upon review of the Stipulation, it appears that portions are unclear and irrelevant, nevertheless, this Commission finds that there is sufficient evidence contained therein to address the question at issue. Therefore, this Commission adopts the Stipulation as the Findings of Fact in this matter and restates them below. The Joint Stipulation of Facts relates only to the years 1974, 1975, and 1976. However, since Case Numbers R-79145 and R-79304 have been consolidated by Order of this Commission, the Stipulation, Conclusions of Law, and Decision will also apply to the year 1973.

Findings of Fact

1. Petitioner is a corporation organized under the laws of the State of Missouri with its principal business office at 808 County Road, Monett, Missouri, 65708.

2. Petitioner was a member of a consolidated group of corporations, of which Revere Copper and Brass, Incorporated is the parent, (herein called the "Parent Company"). Petitioner, for the taxable years ending December 31, 1974, 1975 and 1976, joined with the Parent Company and the other members of the consolidated group in the filing of federal consolidated income tax returns in those years. The members of the consolidated group were not eligible to file a consolidated Missouri income tax return during such years and therefore Petitioner filed a separate Missouri income tax return.

3. Petitioner's 1974, 1975 and 1976 Missouri corporate income tax returns were duly and timely filed with the Missouri Department of Revenue. Petitioner has duly paid the full amount of Missouri corporate income tax as reflected on such returns.

4. The Respondent issued a notice of deficiency dated November 1, 1978 for each of the years 1974, 1975 and 1976.

5. The final notices of state income tax deficiencies are to be taken as mathematically correct. The Audit Report compiled by the Department of Revenue of Missouri concerning the books of Petitioner which gave rise to the Respondent's final notice of state income tax deficiency and the appeal to this Commission is taken as mathematically correct. The auditor(s) who conducted the audit of Petitioner were (are) duly appointed auditors of the Department of Revenue of Missouri qualified to conduct the audit. The figures contained in the Audit Report are an accurate reflection of the figures contained in Petitioner's books and records.

The final notices of deficiency issued by the Missouri Department of Revenue asserted corporate income tax deficiencies during each of the years in question as indicated below, together with interest to the date of the final notice of deficiency:

	Additional Tax	Interest
1974	$34,093	$7,329.99
1975	20,895	3,238.72
1976	32,829	3,118.75

6. Petitioner timely filed a protest letter with the Department of Revenue against the assessments set forth in the final notices of deficiency for the years 1974, 1975 and 1976.

7. The Respondent issued his Final Decision Upon Reconsideration dated May 9, 1979, which upheld the notices of deficiency for each of the years in question and denied the protest filed by Petitioner.

8. Petitioner filed a Complaint with this Commission on June 7, 1979, appealing Respondent's Final Decision Upon Reconsideration and the Assessments set forth in the notices of deficiency. The Appeal was duly and timely filed with this Commission and is properly before this Commission.

9. The aforementioned alleged deficiencies during each of the years in question are primarily due to the recomputation of the deduction for federal income tax liability. Petitioner does not appeal or request an abatement or correction of that portion of the deficiency assessment of the Department of Revenue relating to the different apportionment percentage for income attributable to Missouri for each of the years 1974, 1975 and 1976. Accordingly, Petitioner agrees that its Missouri taxable income should be increased in the amount of $21,568 for 1974, in the amount of $8,264.78 for 1975, and in the amount of $13,561 for 1976, subject, however, to appropriate adjustments by way of deductions for the federal income tax, if any, attributable to said additional net income.

10. In preparing its Missouri corporate income tax returns for each of the years 1974, 1975 and 1976, Petitioner reported as its Missouri income that portion of its federal taxable income, computed as if a separate federal income tax return were filed, which was derived from sources within Missouri. Petitioner took as a federal income tax deduction the federal income tax liability determined on a *separate* return basis (using the maximum statutory rate, less the investment tax credit) and applying thereto the ratio of its Missouri income to its total gross income pursuant to the following formula: The Missouri income percentage calculated pursuant to Section 143.415.2(a), [sic]* times the federal income tax liability of Petitioner determined on a separate return basis.

11. Pursuant to an agreement among the various members of the consolidated group and the financial accounting policy of the group pertaining to the allocation of federal income tax liability, Petitioner was obligated to pay the Parent Company an amount representing its federal tax liability computed on its separate income. Accordingly, Petitioner consistently paid to

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* This proper statute is found in Section 143.451.2, RSMo 1978.

the Parent Company during the years in question the amount it determined as its federal income tax liability on a separate company basis. The aforesaid amounts paid by Petitioner to the Parent Company each year were somewhat larger than the amount used in making the computation for the Missouri return. This occurs because certain deductions (primarily accelerated depreciation) are taken for return purposes that are not taken by the members in computing income for financial accounting purposes. The Parent Company made no election pursuant to Section 1552 of the Internal Revenue Code or the regulations thereunder regarding a method of adjusting earnings and profits for federal income tax purposes.

12. In issuing the aforesaid final notices of state income tax deficiencies, the Respondent took the position that Petitioner's deduction for federal income tax will be limited to deducting a proportionate part of the consolidated federal income tax liability as shown on the consolidated return of the Parent Corporation. The Respondent computed Petitioner's federal income tax deduction pursuant to Section 1552(a)(1)** of the Internal Revenue Code and Treasury Regulation Section 1.1552-1(a)(1) promulgated thereunder by applying the ratio of Petitioner's separate federal taxable income to the sum of the separate federal taxable incomes of those members of the consolidated group having taxable income to the federal income tax liability of the consolidated group (after all credits but before investment credit recapture) plus Petitioner's separate return investment credit recapture and foreign tax credits as follows:

** Respondent contends in its brief (p.11) that it utilizes subsection 2 of Section 1552(a), *not* subsection 1. The subsections are alternative accounting methods. The formula in Stipulation #11 is more consistent with Section 1552(a)(1). *See* Footnote 3.

$$\frac{\text{Petitioner's Separate Federal Taxable Income}}{\text{Sum of the Separate Federal Taxable Incomes Attributable to Each Member of the Group Having Taxable Income}} \times \text{Federal Tax Paid by Consolidated Group (after all credits but before investment credit recapture)} + \text{Petitioner's Separate Return Investment Credit Recapture and Foreign Tax Credit}$$

Such method in effect gives no regard to any losses suffered by members of the group in computing the federal taxable income for purposes of the first ratio in the above formula, but such losses are taken into account in determining the federal tax liability of the consolidated group to which the first ratio above is applied.

Conclusion of Law

I.

Petitioner is one of several corporate subsidiaries (hereinafter referred to as "the members") which, together with the Parent Company, are part of a larger affiliated group of corporations (hereinafter referred to as "the group"), which band together by pooling their incomes and expenses to file a federal consolidated income tax return. In the instant case, Petitioner's affiliated group filed a *consolidated* federal income tax return. However, Petitioner was required to file a separate Missouri income tax return. The sole issue is whether Petitioner's method of determining the amount of federal income tax to be reported as a deduction on its Missouri income tax return in calculating its Missouri taxable income for the years in question was proper.

Before proceeding into a discussion of the facts, it is necessary to review the applicable federal and state tax procedures.

II.

FEDERAL TAX PROCEDURE

Pursuant to Section 1501 of the Internal Revenue Code of 1954 (hereinafter the Code), an affiliated group of corporations may combine the profits and losses of its members and file a single consolidated federal income tax return in lieu of separate returns by each of the members.[1] Accordingly, the only federal

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[1] Section 1501, entitled "Privilege to file consolidated returns", provides:

> *An affiliated group of corporations shall,* subject to the provisions of this chapter, *have the privilege of making a consolidated return* with respect to the income tax imposed by chapter 1 for the taxable year *in lieu of separate returns.* The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group. (Emphasis added.)

For a general discussion of the law of affiliated corporations and their consolidated returns, *see* Bittker and Eustice, *Fundamentals of Federal Income Taxation of Corporations and Shareholders,* paragraphs 15.20-15.24 (1st ed. 1980). Paragraph 15.21 of that text succinctly states the stock ownership requirements an affiliated corporation must meet in order to file a consolidated return:

> The stock ownership rule of §1504(a) requires that the "affiliated group" consist of one or more chains of includible corporations connected through stock ownership with a common parent corporation (which must also be an includible corporation) in the following manner:
>
> (1) Stock with at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (other than the common parent) must be owned directly by one or more of the other includible corporations: and

tax payment made to the United States Treasury by the several corporations which consolidate is that made by the group. Thus, for tax purposes, the group is an independent entity. Section 1552 of the Code provides four alternative methods to determine the amount of consolidated tax liability to be allocated to each member of the group.[2]

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(2) The common parent must own directly stock with at least 80 percent of the voting power of all calsses of stock and 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

The prescribed amount of stock must, under §1515(a), be owned "directly" by members of the affiliated group, so that two corporations whose stock is owned by an individual or group of individuals, or by a non-includible corporation do not constitute "an affiliated group of corporations." Every includible corporation must participate in the consolidated return it is not possible to exclude a particular corporation because of possible objections by its minority shareholders. (Footnotes omitted.)

Further, as the authors state in paragraph 15.23: "Whether an affiliated group should elect to file a consolidated return depends upon a variety of complex and competing factors."

[3] Section 1552, entitled "Earnings and profits", provides:

(a) General rule.-Pursuant to regulations prescribed . . . the earnings and profits of each member of an affiliated group required to be included in a consolidated return for such group filed for a taxable year shall be determined by *allocating the tax liability* of the group for such year *among the members of the group* in accord *with whatever of the following methods the group shall elect* in its first consolidated return filed for such a taxable year:

(1) The tax liability shall be apportioned among the members of the group in accordance with *the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.*

Petitioner's Parent Company made no election pursuant to Section 1552 regarding a method of allocating the consolidated tax liability to the members. If no election is chosen, subsection (b) of Section 1552 provides that the consolidated tax liability shall be allocated among the several members according to the method prescribed in subsection (a)(1) of Section 1552. This subsection provides the following formula, as contained in Treasury Regulation Section 1.1552-1:[3]

> (2) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member *if computed on a separate return* would bear to the total amount of the taxes for all members of the group so computed.
>
> (3) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be allocated on the basis of the contribution of each member of the group to the consolidated taxable income of the group. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their tax liabilities determined on a separate return basis and their tax liabilities based on their contributions to the consolidated taxable income.
>
> (4) The tax liability of the group shall be allocated in accord with any other method selected by the group with the approval of the Secretary.
>
> (b) Failure to elect.-If no election is made in such first return, the tax liability shall be allocated among the several members of the group pursuant to the method prescribed in subsection (a)(1). (Emphasis added.)

[3] The "sum of the members" denominator in this formula does not take into account the losses of the other members as it only requests the sum total of all members with a taxable income, and a loss does not represent taxable income. The consolidated group's FTI multiplier *does* consider the losses of other members however, as it seeks the group's net income, which must take into account all the member's profits and losses.

$$\frac{\text{taxable income of the member}}{\text{taxable income of all members having taxable income}} \times \text{consolidated tax liability}$$

The members in Petitioner's group did not pay into the group only that amount of consolidated tax liability as computed by Section 1552 but instead chose to enter into an agreement whereby they would pay into the group an amount equal to their separate return tax liability *as if* they had filed a separate federal income tax return. This amount was somewhat larger than the amount the members would have been obligated to pay under Section 1552.[4]

The parties also state that Petitioner "made no election pursuant to Section 1552 . . . or the regulations thereunder regarding a method of adjusting earnings and profits by allocation of the tax liability of the group for federal income tax purposes." However, Section 1552 is a mandatory provision requiring an election for allocating the group's tax liability to the member. Therefore, according to Section 1552(b), the group's failure to elect a method of allocation pursuant to Section 1552(a) resulted in allocation pursuant to the method prescribed in Section 1552(a)(1) for federal income tax purposes.

Pursuant to Treasury Regulation Section 1.1502-33(d)(2)(ii), the members may enter into an agreement and pay into the group an additional amount of money as an earnings and profits adjustment which, put very simply, allows the earnings of

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[4] The parties claim that this amount is larger "because certain reductions (primarily accelerated depreciation) are taken for return purposes that are not taken by the members in computing income for financial accounting purposes".

one member to be shifted to another member.[5] The formula for determining this additional amount may be stated as follows:

A fixed % (fixed by the parties - not to exceed 100%)	X	The members separate return tax liability minus member's allocated liability under Section 1552(a)(1)

This additional amount, added to the amount the member would pay under Section 1552, totals to the same amount the parties stated that they agreed to pay into the group. The member's "separate return tax liability" is the amount the member would have paid if it had filed separately, i.e. *as if* it

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[5] Section 1502 of the Internal Revenue Code provides that the Secretary of the Treasury shall prescribe rules and regulations to govern the entire consolidated return area. These regulations, Treas. Reg. 1.1502 et seq., now provide the corpus of the law on consolidated returns.

Treasury Regulation Section 1.1502-33(d)(2) provides:

> (ii)(a) The tax liability of the group, as determined under paragraph (b)(1) of §1.1552-1, shall be allocated to the members in accordance with paragraph (a)(1), (2) or (3) of §1.1552-1, which ever is applicable;
>
> (b) *An additional amount shall be allocated to* each member equal to *a fixed percentage* (which does not exceed 100 percent) *of the excess, if any, of* (1) *the separate return tax liability of such member* for the taxable year (computed as provided in paragraph (a)(2)(ii) of & 1.1552-1), *over* (2) *the tax liability allocated to such member in accordance with (a) of this subdivision (ii); and*
>
> (c) *The total* of any *additional amounts* allocated pursuant to (b) of this subdivision (ii) (including amounts allocated as a result of a carryback) shall be credited to *the earnings and profits of those members which had items of income, deductions, or credits* to which such total is attributable pursuant to a consistent method which fairly reflects such items of income, deductions, or credits, and which is substantiated by specific records maintained by the group for such purpose. (Emphasis added.)

had filed a separate federal income tax return.[6] Thus, even though the parties stipulate that Petitioner did not elect an earnings and profits adjustment provision under the regulations, upon review, this Commission finds there is no difference between the amount Petitioner paid under the agreement between the affiliated parties and the amount that is required to be paid under Section 1552 plus the Section 1.1501-33(d)(2)(ii) adjustment addition.

In order to better comprehend the interaction of this myriad of statutes and regulations, including the later discussion of Missouri statutes on point, this Commission offers the following hypothetical:[7]

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[6] This "hypothetical" formula is used in Federal and Missouri statutes concerning the law of consolidated returns for income tax computation purposes. This same hypothetical formula for computing a member's separate return liability will be referred to many times throughout this opinion.

Section 1552(a)(2) uses the hypothetical language to determine the allocable share of tax a member must pay to the consolidated group. (*See* emphasized the language in footnote 3, *supra*). This subsection provides the following formula, as obtained in Treas. Reg. Section 1.1552-1:

$$\frac{\text{member's tax (separate return basis)}}{\text{total taxes of all members having tax (computed on separate return basis)}} \times \text{consolidated tax liability}$$

Missouri also has a statute which utilizes the hypothetical formula (*See* Section 143.431, *infra*) for determining federal taxable income in the context at length later in this opinion.

[7] This is, of course, a very simplistic overview of the multifaceted and complex area of consolidated returns. The purpose of the example is merely to pull together the many statutes and regulations and demonstrate the manner in which they interrelate. The example is *not* a refined, detailed or sophisticated example of the actual tax structure of affiliated corporations.

Assume corporations A and B have net income of $20 and $30 respectively, and corporation C had a net loss of $10. Under normal tax conditions, assuming a constant 50% tax rate, A would pay $10 in federal income tax, B would pay $15, and C would pay nothing. A total of $25 would be paid to the U. S. Treasury.

If, however, these three corporations joined together as an affiliated group of corporations, pursuant to Section 1501 and the regulations promulgated pursuant to Section 1502, a parent corporation would file a consolidated federal income tax return in lieu of the members' (A, B and C) separate federal income tax returns. This consolidated return would claim a federal taxable income (FTI) of $40, which, assuming a 50% tax rate, would result in a $20 payment ot the U. S. Treasury. Example:

A B C Parent	U. S. Treasury
$20 + $30 - $10 = $40	X 50% tax rate = $20

We must then turn our attention to Section 1552 which allocates the groups federal income tax liability to the members. Example for member corporation A:

A's Federal taxable income (FTI) / A, B and C's FTI	X PARENT's liability to Treasury	= A's proportionate share of the group's federal income tax liability

or

$$\frac{\$20}{\$20 + \$30 + \$0} \quad X \quad \$20 = \$8$$

Under this formula A would pay $8, B would pay $12 and C would pay $0 of the group's $20 tax liability to the U. S. Treasury.[8]

If the members entered into an agreement pursuant to Section 1.1502-33(d)(2)(ii), member corporation A would agree to pay an additional $2, B would pay an additional $3 and C again would pay nothing. This can be seen by the following example for member corporation A:

100% X (A's separate return tax liability - A's liability under Section 1552)

or

100% X (($20 X 50% tax rate)-$8) = ($10-$8) = $2

Thus, the total payments show that A has paid $10 into the group, B has paid $15 and C has paid $0, or the members have paid a total tax of $25.

Essentially, combining Section 1552 and Section 1.1502-33(d)(2)(ii) results in each member paying into the group an amount equal to its separate return tax liability (the amount Petitioner claims it paid to the group).

The total of the amounts paid into the group is $25, although the group's tax liability to the federal government is only $20. The extra $5 is credited to the $10 loss that C suffered in that taxable year.[9] In the ordinary tax situation,

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[8] The same figure would be obtained using subsection (2) of Section 1552:

$$\frac{\text{A's separate}}{\text{A,B,\&C's separate}} \times 20 = \frac{20 \times 50\%}{20+30+0 \times 50\%} \times 20 = \frac{10}{25} \times 20 = 8$$

[9] There may be additional refinements necessary for the true computation of a member's separate return tax liability which are not being accounted for in this example. Further, for the purposes of this example, it is assumed that the corporation as a separate entity is being taxed at a 50% rate, and the members chose the 100% fixed rate.

i.e. if C had filed as a separate corporation and not a member of a consolidated group, C would have been able to take advantage of a $10 loss as a net operating loss carryback or carryforward against its past or future profits in other tax years. The advantage of this intragroup agreement is that C may immediately account for this loss and need not rely on accounting for the loss with the uncertain carryback or carryover possibilities (uncertain because the corporation may not have profits in the past or the future it may use the carryback or carryforward against). In sum, the extra $5 remains within the group of consolidated subsidiaries; the Parent pays $5 less in taxes to the U.S. Treasury; and C takes immediate advantage of its losses although losing its carryback or carryforward privilege.[10]

It should be emphasized that all of these transactions under Section 1.1502-33(d)(2)(ii) are voluntarily entered into by the members and are entirely intragroup in nature, i.e. the federal or state governments are not involved. The U.S. Treasury receives the same amount of tax dollars when a Section 1.1502-33(d)(2)(ii) agreement is utilized as it does when it is not. In conclusion, the tax advantage to the group in filing a consolidated federal income tax return is to lessen its tax liability and funnel the savings directly back into the group of subsidiaries for immediate business use.

III.

STATE TAX PROCEDURE

In discussing state tax procedure, it should first be noted that, although Petitioner elected to file a consolidated federal income tax return, it was required to file a separate state income tax return for the reason that more than 50% of its income was

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[10] *See* Bittker and Eustice, *supra footnote 1*, paragaraph 15.23 for further discussion of the various advantages and disadvantages of consolidating.

derived from sources outside of the state. *See* Section 143.431.3(1), RSMo 1978.[11] What makes this dichotomy problematic, and is at the heart of the issue here involved, is that Missouri allows the individual member, Petitioner, a deduction from its Missouri adjusted gross income equal to the "federal income tax liability" of that member. Section 143.171.1, RSMo 1978, provides:

> A taxpayer shall be allowed a deduction for his *federal income tax liability* under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed after reduction for all credits theron, except the credit for payments of federal estimated tax, the credit for the overpayment of any federal tax, and the credits allowed by the Internal Revenue Code of 1954 by Section 31 (tax withheld on wages), Section 33 (tax of foreign country and U.S. possessions), and Section 39 (tax on certain uses of gasoline, special fuels, and lubricating oils). (Emphasis added.)

However, because Petitioner did not actually file a separate federal income tax return, one must look elsewhere to ascertain what the term "federal income tax liability" means, so that one can then determine Petitioner's federal tax deduction in arriving at Missouri taxable income.

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[11]. Section 143.431.3(1), RSMo 1978, allows certain qualified consolidated groups of corporations to elect to file a consolidated Missouri income tax return in lieu of separate returns. That Section provides:

> If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within this state as determined in accordance with section 143.451, then it may elect to file a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income.

Section 143.431.3(4), RSMo 1978 provides:

> For each taxable year an affiliated group of corporations filing a federal consolidated income tax return does not file a Missouri consolidated income tax return, *for purposes of computing the Missouri income tax, the federal taxable income of each member* of the affiliated group *shall be determined as if a separate federal income tax return had been filed* by each such member. (Emphasis added.)

Section 143.431.3(4) requires a member of a consolidated group to determine its "federal taxable income" allocable to Missouri *as if* it had filed a separate return. This, the statute posits, is necessary in order to determine the member's *Missouri taxable income*, which in turn becomes the basis for determining that member's *Missouri income tax*.[12] This hypothetical method of computing tax is mentioned only with regard to computing the taxpayer's "federal taxable income", and does not mention the Missouri deduction for federal income tax.

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[12] Section 143.431.1, RSMo 1978 defines "Missouri taxable income" for corporations:

> The *Missouri taxable income* of a corporation taxable under section 141.011 to 143.996 *shall be so much of its federal taxable income* for the taxable year, *with the modifications specified in subsections 2 and 3 of this section, as is derived from sources within Missouri as provided in section 143.451.* The tax of a corporation shall be computed on its Missouri taxable income at the rates provided in section 143.071. (Emphasis added.)

Subsection (2) of Section 143.431 provides in part that "(t)here shall be subtracted (from federal taxable income) the federal income tax deduction provided in Section 143.171."

Section 143.451.8, RSMo 1978, provides the method for determining the amount of federal taxable income derived from sources in Missouri:

> If a corporation derives only part of its income from sources within Missouri, its Missouri taxable income shall only reflect the effect of the following listed deductions to the extent applicable to Missouri. The deductions are: (a) its deduction for

IV.

Petitioner would read the foregoing statutes to allow a member of an affiliated group, filing a separate state return, to deduct on its state return the amount of federal income tax it would have paid to the federal government had it filed a separate federal income tax return. It bases this interpretation upon the supposition that because Section 143.431.3(4) directs a member of an affiliated group filing a separate state return to determine its *federal taxable income* as if it had filed a separate federal return, then such member should also determine its federal income tax *deduction* in the same manner, i.e., *as if* it had actually paid such federal income tax.

Petitioner argues that the term "federal income tax liability" as contained in Section 143.171.1 does not require actual payment of its federal income tax to the federal government, but claims that the term "liability" pertains only to the amount for which it would have been liable if it had filed a separate federal income tax return. Petitioner contends that Section 143.171.1

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federal income taxes pursuant to section 143.171, and (b) the effect on Missouri taxable income of the deduction for net operating loss allowed by Section 172 of the Internal Revenue Code. *The extent applicable to Missouri shall be determined by multiplying the amount that would otherwise affect Missouri taxable income of the corporation for the year divided by the Missouri taxable income for the year as though the corporation had derived all of its income from sources within Missouri.* For the purpose of the preceding sentence, Missouri taxable income shall not reflect the listed deductions.

The "old" statute, Section 143.040.1, RSMo 1969, allowed a deduction for "such portion of [federal income] taxes . . . as the gross income from all sources within this state shall bear to the gross income of the corporation from all sources." The change from a "gross" to a "net" income ratio was based on the Internal Revenue Code's reliance on net rather than gross income in determining taxes. See IRC Section 1552. *See also* Section 143.961, RSMo 1978, *infra*, for the proposition that Missouri rules follow the rules and regulations of the Treasury Secretary as nearly as practicable. (Emphasis added.)

does not specify that the "liability" must be payable to any certain entity - it need only arise by reason of the federal income tax. Thus, its "hypothetical" liability should suffice for purposes of the statute.

Petitioner bases its contention on the 1973 change to the statute concerning federal income tax deductions for Missouri corporations. Under the "old" statute, Section 143.040.1, RSMo 1969, a deduction was allowed for "...such portion of *taxes assessed* by the United States against the taxpayer as the gross income from all sources within this state shall bear to the gross income of the corporation from all sources." (Emphasis added.) Effective January 1, 1973, Section 143.040 was repealed and Sections 143.171 and 143.431 were enacted in its place. A deduction for "federal income tax liability" (reduced by certain credits) replaced the "taxes assessed" language.

Respondent, on the other hand, has limited Petitioner to a deduction in the amount of a proportionate share of the income tax paid by the affiliated group as computed in the group's consolidated federal income tax return, i.e. Petitioner's tax liability determined by Section 1552(a)(1) (as adjusted by the credits referred to in Section 143.171.1, *supra*). Petitioner has appealed from Respondent's Decision to this Commission for a resolution of this matter.

In *Armco Steel Corporation* v. *State Tax Commission*, 580 S.W.2d 242 (Mo. banc 1979), the court decided much the same issue as in the case at bar under the "old" statute. In *Armco*, a parent company had formed a consolidated group with its subsidiaries and attempted to take federal income tax deductions on its separate Missouri income tax return equal to the amount it would have been liable for had it filed a separate federal income tax return, i.e. the hypothetical amount. The Missouri Supreme Court held that although the parent company must determine its *federal taxable income* using the hypothetical formula, the same hypothetical formula could not be used to determine the *federal income tax deduction* to which the parent was

entitled in computing its Missouri income tax. The court decided that the words "tax assessed" contained in the "old" statute referred to monies *paid* into the U.S. Treasury, and *not* what the taxpayer would have been liable for *if* it had filed a separate return.

Petitioner maintains that the change in the statutes in 1973 from "taxes assessed" to "federal income tax liability" was intended to allow for the deduction denied under the "old" statute in *Armco*. Petitioner claims that if the Missouri legislature intended "taxes assessed" to mean the same thing as "federal income tax liability", it would have left the statutory language the same.

Respondent does not deny that there was a substantive change in the statutes in question in 1973, but contends that the change was unrelated to *the amount* of the federal income tax deduction. Respondent maintains that the change was made to deal with procedural difficulties encountered under the "old" statute as to *when* (i.e. which taxable year) to allow the federal income tax deduction in cases where the federal income tax arises from a past taxable year. Respondent claims that this, as well as other technical problems with the "taxes assessed" language in the "old" statute, was the impetus for the change to the "federal income tax liability" language of the "new" statute.

Once again, an example is perhaps the best way to facilitate the discussion of how Respondent claims the change to the "liability" language helped to eradicate several problems encountered under the "old" statute. Assume that a taxpayer fails to report additional amounts of federal taxable income for the year 1973. This inadvertency is discovered by the Internal Revenue Service in 1977 which in turn issues an additional assessment that same year. In 1978 the taxpayer pays to the U.S. Treasury the amount in question. The taxpayer wishes to deduct this additional amount of federal taxes paid on its Missouri income tax return, but there are several problems involved in doing so.

The major problem involves what tax return year the deduction should be taken. There are three possibilities: (1) the year the taxpayer was *liable* for the additional federal income tax (1973); (2) the year the additional income was discovered and the right to the Missouri deduction *accrued* to the taxpayer (1977); or (3) the year the additional income was "assessed", which the *Armco* decision declared was when the tax is actually paid into the U.S. Treasury (1978). There are several reasons why one year as opposed to another may be important. The first involves possible tax rate changes or allocation rate changes[13] which occur between the tax years in question. The tax or allocation rate could change between 1973 and 1978 such that the taxpayer could receive more or less of a deduction in one year than it would have in a different year. Second, there are potential problems with the statute of limitations.[14] For example, the applicable statute could bar Respondent's additional assessment in 1978 but not in 1977.[15] Finally, there could be pro-

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[13] The term "allocation rate" refers to the percentage of business income which a certain consolidated group member transacts in a particular state. In 1973, corporation A could have been transacting 90% of its business in Missouri whereas in 1978 this percentage could be 10%. Thus, the corporation could be entitled to a Missouri federal income tax deduction much higher in 1973 than in 1978.

[14] The term statute of limitations is not entirely apt in the context of a tax deduction, because the state is unqualifiedly entitled to its tax dollar, and only provides for the federal income tax deductions out of legislative grace. There is nothing unconstitutional about the federal *and* state governments both taxing the same income. The legislature has imposed a limitation upon the state's ability to collect that tax dollar however, as it has imposed this form of statutory laches on the director of revenue to prevent undue delays in additional assessments.

[15] The "old" limitations statute was four years. Section 143.240, RSMo 1969 provided:

> In case *any taxpayer shall fail to make return* as required by law, *the director* of revenue shall have authority to *estimate the*

blems with whether or not the additional federal income must be accounted for in Missouri as concomitant Missouri taxable income, i.e. Respondent will desire to account for the additional income taken in by the taxpayer in 1973 in one of the three years possible. In sum, there are several reasons why the year in which the federal income tax deduction may be taken on a taxpayer's Missouri income tax return is important. The decision in *Armco* shows how these problems can surface.

In *Armco,* the court held that the language "taxes assessed" in the "old" statute meant tax dollars paid into the U.S. Treasury, such that the taxpayer (the parent company in *Armco*) was entitled to a deduction equal only to that amount paid, *not* the amount it would have paid if it had filed separately. Under *Armco,* the deduction should be taken in the tax year in which the taxes were "assessed", which in the above example would be 1978. As was mentioned, a deduction in 1978 for 1973 income may entail several procedural problems. Respondent claims that because of such problems the statute was amended in 1973.

Section 143.171.1, RSMo 1978, allows a deduction from Missouri income tax for "federal income tax liability. . . *for the same taxable year for which the Missouri return is being filed. . .". Under the emphasized language the taxpayer must take its deduction in the year for which it was liable* for the additional assessment (in the example this would be 1973). The 1973 amendment sought to avoid the aforementioned procedural problems by changing the year in which the deduction is allowed from the year the taxes were "assessed" to the year which form-

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amount of such taxpayer's income, from such sources as he may be able to obtain including the business, records and books of any taxpayer, which business, records and books the director of revenue is hereby given the right to examine during the usual business hours *at any time within four years after the return of such taxpayer is required by law to be filed, and the director of revenue shall thereupon make the assessment including all penalties and interest provided.* (Emphasis added.)

ed the basis for the additional assessment, the year for which the return was filed. This change allows the deduction to be based on the tax and allocation rates of the year of the federal tax which allows for the Missouri deduction.[16]

In addition to Section 143.171.1 and Section 143.431.3(4), other provisions were amended to conform to the "liability" language. Section 143.601, RSMo 1978 was passed to make it a requirement that taxpayers report any changes in their federal income tax to the Department of Revenue. The statute requires the taxpayer amend its Missouri income tax return for the year in which it was liable for the taxes on the additional income.[17]

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[16] Section 143.171.2, RSMo 1978 provides:

> If a federal income tax liability for a tax year prior to the applicability of section 143.011 to 143.966 for which he was not previously entitled to a Missouri deduction is later paid or accrued, he may deduct the federal tax in the later year to the extent it would have been deductible if paid or accrued in the prior year.

This subsection is included to accomodate for "transition" years, i.e. where an additional assessment may be made in a "new" statute year for taxes for which the taxpayer was liable in an "*old*" statute year. The subsection provides that if, for example, a taxpayer is liable for additional income in 1968 but this income is not discovered by the Internal Revenue Service until 1973, the deduction may be taken on the 1973 Missouri income tax return "to the extent it would have been deductible if paid or accrued in the prior year."

[17] Section 143.601, RSMo 1978, states:

If the amount of a taxpayer's federal taxable income reported on his federal income tax return for any taxable year is *changed or corrected by the United States Internal Revenue Service* or other competent authority, or as the result of a renegotiation of a contract or subcontract with the United States, *the taxpayer shall report such change or correction* in federal taxable income within ninety days after the final determination of such change, correction, or renegotiation, or as otherwise required by the director of revenue. Each such report shall state whether and wherein the determination is believed to be er-

Further, the present statute of limitations provision has a specific subsection to accommodate the changes in Section 143.171.1 Section 143.711, RSMo 1978[11] removes the "old" statute's four year statute of limitations and imposes what can be referred to as a statutory form of the doctrine of equitable laches on the power of the Respondent to issue additional assessments. Thus, there is no actual limitation on Respondent's ability to issue an additional assessment, except that once it is aware of a taxpayer's failure to report income, it has only one year to issue its notice of deficiency based on the additional income. In sum, Respondent contends that the change in the Missouri federal income tax deduction statute was both substantive and meaningful, but was not concerned with the amount of the deduction but with the many procedural irregularities that arose under the "old" statute.

It is readily certain that the "old" statute and the "new" statute vary considerably in their effects. This Commission is convinced that these changes definitely affect *when* the deduction may be taken and many other aspects of taking the deduc-

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roneous. *Any taxpayer filing an amended federal income tax return shall also file within ninety days thereafter an amended return under sections 143.011 to 143.996,* and shall give such information as the director of revenue may require. (Emphasis added.)

[11] Section 143.711.4, RSMo 1978, states:

> If a taxpayer fails to comply with the requirement of section 143.601 by not reporting a change or correction increasing his federal taxable income or by not filing an amended return, a notice of deficiency may be mailed to the taxpayer within *one year* after the director of revenue shall become aware of such determination. A notice under this subsection shall be limited to the effects on Missouri taxable income of:
>
> (1) The issues on which the federal determination is based, and
>
> (2) Any *change in the amount of his federal income tax deduction under the provisions of subsection 1 of section 143.171.* (Emphasis added.)

tion. However, Petitioner has failed to prove that the legislature intended these changes to affect the amount of the deduction.

Furthermore, we find that Respondent's method which it used to determine the amount of a Missouri deduction to which individual members of a consolidated group are entitled is reasonable. Respondent adhered to the formula provided in IRC Section 1552(a)(1) for determining a member's tax liability to the group in order to allocate the Missouri deduction for federal income tax amongst the members of the group. Respondent maintains that a literal interpretation of Section 143.171.1 could be interpreted to not entitle an individual member to any deduction whatsoever, because the members themselves are not "liable" to the U.S. Treasury at all. Only the group is actually "liable" to pay to the U.S. Treasury the required tax dollars. Respondent has, however, realized that because the group itself often does not file a consolidated Missouri income tax return, it should in its discretion, provide a method to allow the members what the legislature seems to have intended to allow Missouri business concerns, a federal income tax deduction.

In determining the amount of the deduction allotted either the group or its members or any taxpayer, Respondent looks only to the amount of money to which the U.S. Treasury was entitled. Respondent's method for determining the amount of a deduction for federal income tax liability to which Petitioner is entitled is consistent with the spirit and intent of the *Armco* decision, *supra*. This Commission recognizes that *Armco* was decided for a tax year prior to the 1973 amendments to Chapter 143, RSMo. However, the primary rule of statutory construction is to ascertain the legislative intent. *Missourians for Honest Elections* v. *Missouri Elections Commission*, 536 S.W.2d 766, 772 (Mo. App. 1976). Additionally, Section 161.273, RSMo 1978, provides that "[i]n any proceeding before the Administrative Hearing Commission under this section the burden of proof shall be on the taxpayer. . . ." Petitioner has failed to

prove that the 1973 amendments to Chapter 143, RSMo, were intended to change the results of the *Armco* decision as it affected the amount of the federal income tax deduction.

Furthermore, Section 143.961.1, RSMo 1978, provides that the Director of Revenue "is authorized to make such rules and regulations. . .as he may deem necessary to enforce the provisions of sections 143.011 to 143.996 [Chapter 143, RSMo 1978, Income Tax]." Once again, Petitioner has failed to show that the Director of Revenue has exceeded that authority by adopting this policy. Such a policy is consistent with the Internal Revenue code's mandatory provision for allocation of the group's tax liability to the members, and, therefore, is consistent with 143.961.2, RSMo 1978, which provides that "[t]he rules and regulations prescribed by the Director of Revenue shall follow as nearly as practicable the rules and regulations of the Secretary of the Treasury. . . ." In light of this consistency with the Internal Revenue Code and Section 143.961.2, Respondent was reasonable in adopting this policy.

This Commission realizes that Respondent's position will lead to inconsistent formulas being used to determine the Missouri taxable income and the allowable deduction for federal income tax liability. The formula for determining Missouri taxable income will not take into consideration the losses of the other members of the group. The formula for determining the allowable deduction for federal income tax liability will take such losses into consideration. However, this is exactly the same result reached in the *Armco* case. As previously pointed out, Petitioner has failed to prove any legislative intent to change the result of the *Armco* decision. Therefore, this inconsistency does not render Respondent's position unreasonable.

Petitioner contends that Respondent's method for determining the allowable federal income tax deduction is a denial of equal protection in that it will pay more state income taxes than corporations which are not members of an affiliated group

under such a method. It must be remembered that the issue before this Commission is the amount of a deduction, not the amount of a tax. The amount of the tax is set by Section 143.071, RSMo 1978, and 5% for all corporations, including Petitioner. The amount of the deduction is set by Sections 143.171 and 143.431, RSMo 1978. "Deductions for income tax purposes are a matter of legislative grace. The burden is on the taxpayer seeking a deduction to demonstrate that he comes within the terms of the statute granting that privilege." *Mobil Oil Corporation* v. *State Tax Commission of Missouri,* 513 S.W.2d 319, 322-23 (Mo. 1974). Petitioner has failed to demonstrate that he is entitled to the deduction he claims.

This Commission finds no substance in Petitioner's equal protection argument. Petitioner voluntarily chose to do its business as a member of an affiliated group. In doing so, Petitioenr voluntarily removed itself from the class with which it now seeks to be identified.

Finally, Petitioner contends that Respondent's method is in direct conflict with Section 143.171.1, *supra,* because that section allows a deduction for the "federal tax liability under *Chapter 1* of the Internal Revenue Code" because Respondent's method is in accordance with the chapter on consolidated returns, *Chapter 6* of the Internal Revenue Code. It must be remembered that Treasury Regulation 1.1502-2(a) imposes upon the consolidated taxable income of the group the tax imposed by Section 11 of the Code. Section 11 is found in Chapter 1 of the Code. Chapter 6 of the Code merely grants the privilege to file consolidated returns, applies the Chapter 1 tax to the consolidated taxable income of the group, and allows for allocation of that tax liability to the members. Therefore, this Commission does not find any conflict between the Respondent's method and Section 143.171.1.

Decision

For the reasons stated hereinabove, it is the decision of this Commission that Petitioner is liable for additional tax in the amount of $12,504.37 for 1973, $34,093 for 1974, $20,895 for 1975, and $32,829 for 1976, together with interest thereon from date of assessment until date of payment. Wherefore, it is hereby ordered that this case be dismissed from the Commission's docket.

DATED this 3rd day of August, 1981.

HON. MICHAEL C. HORN
Commissioner

No. 83-863

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1983

MID-AMERICA TELEVISION COMPANY
and
OLIVER ADVERTISING, INC.,
Petitioners,
v.
STATE TAX COMMISSION OF MISSOURI
and
DENNIS K. HOFFERT, Chairman,
and
ROBERT C. SNYDER, Commissioner,
Respondents;
WELLS ALUMINUM, INC.,
Petitioner,
v.
ADMINISTRATIVE HEARING COMMISSION
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF MISSOURI

BRIEF OF RESPONDENTS IN OPPOSITION TO WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I.

Whether the Missouri Income Tax Law as construed by respondents violates the Equal Protection provision of the Fourteenth Amendment to the Constitution of the United States in that it requires corporate taxpayers filing individual Missouri returns to deduct only a proportionate share of the federal income tax actually paid in the consolidated federal return filed by the affiliated group to which the individuals belong rather than allowing a deduction on the basis of the federal taxes which would have been paid had the individual member filed an individual federal income tax return?

II.

Whether the Missouri income tax law violates the Equal Protection provision of the Fourteenth Amendment to the Constitution of the United States in that it only permits the filing of a consolidated Missouri return where a consolidated federal return was filed and the affiliated group conducts more than half of its business activities within this state?

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ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF MISSOURI

BRIEF OF RESPONDENTS IN OPPOSITION TO WRIT OF CERTIORARI

SUPPLEMENTAL STATEMENT OF THE CASE

Petitioners herein attempt to create an Equal Protection violation of the Fourteenth Amendment to the United

States Constitution and thereby obtain a writ of certiorari to the Supreme Court of Missouri because of the construction of the Missouri income tax law as applied to the petitioners in determining the appropriate deduction for federal income tax liability. Petitioners have filed jointly for a writ of certiorari because of the identity of issues even though the controversies were separate below. Both petitioners are members of affiliated groups of corporations which filed consolidated federal income tax returns and paid a single federal income tax as a consolidated group. However, both petitioners filed separate Missouri corporate income tax returns.

In 1972, the General Assembly of Missouri passed a comprehensive income tax law for the state, effective January 1, 1973. 1972 Laws of Missouri, S.B. 549. In part, the law was based upon the enactment of Art. X, § 4(b), Missouri Constitution, which allowed the General Assembly to define income by reference to the laws of the United States. In keeping with this article, § 143.431.1, RSMo 1978,[1] provides that the starting point for determining Missouri taxable income is federal taxable income. When an affiliated group of corporations files a consolidated federal income tax return and a consolidated Missouri return, the federal consolidated taxable income becomes the Missouri taxable income for that group. In § 143.431.3(1), RSMo 1978, an affiliated group of corporations filing a consolidated income tax return for federal income tax purposes is permitted to file a Missouri consolidated income tax return if fifty percent or more of the group's income is derived from sources within this state.

However, for those corporations who are not permitted to file a consolidated return under the Missouri statute, or

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[1]All references to the income tax law of Missouri are to the 1978 edition unless otherwise noted.

who elect not to, the Missouri legislature created a means of determining Missouri taxable income without reference to the federal return since the federal return dealt with the consolidated group and not the individual members thereof. Accordingly, in § 143.431.3(4), RSMo 1978, individual members of an affiliated group filing a federal consolidated return but not filing a Missouri consolidated return are required to determine federal taxable income as if a separate federal income tax return had been filed and to use this hypothetical figure as the starting point on its Missouri return, i.e., Missouri taxable income.

Although petitioners now claim that the Missouri law restricting the filing of a consolidated Missouri income tax return to those affiliated groups of corporations who file a federal consolidated income tax return and derive fifty percent or more of the group's income from sources within this state is constitutionally suspect, petitioners' original allegations dealt only with the appropriate deduction to be allowed on the Missouri income tax return for federal income tax liability. In Missouri, deductions from tax are matters of legislative grace and the taxpayer claiming a privilege must demonstrate that he comes within the terms of the statute. *Mobil Oil Corporation* v. *State Tax Commission of Missouri*, 513 S.W.2d 319, 322-23 (Mo. 1974). Section 143.171.1, RSMo 1978, allows a taxpayer in Missouri to deduct his federal income tax liability under Chapter 1 of the Internal Revenue Code for the same taxable year for which the Missouri return is being filed, with certain modifications not material to this controversy. This section has been made specifically applicable to corporations by § 143.431.2, RSMo 1978, with the added restriction that where a corporation derives only part of its income from sources within Missouri, the deduction available under § 143.171 is allowed only the extent applicable to Missouri. Section 143.451.8, RSMo 1978.

Although nothing in Missouri law specifically authorizes the practice, petitioners claim the right to hypothetically calculate the federal income tax payable had they filed an individual federal income tax return and use that hypothetical figure as their federal income tax liability for purposes of deduction. For the tax year in controversy, Oliver Advertising, Inc., would have paid $50,491 in federal tax had it filed as an individual corporation. Mid America Television Company would have paid $63,531 to the Federal government in payment of its federal income tax had it filed on a separate basis rather than as a member of a consolidated group. Yet, the record demonstrates that the federal tax actually paid by the consolidated group to which these two petitioners belonged for the year in question was $14,933.

Since the only amount paid as a federal income tax liability to the United States Government was the amount paid by the affiliated group to which these two petitioners belonged, the Missouri Director of Revenue denied the right to deduct as federal income tax on the Missouri returns an amount which would have been paid as federal income tax if the petitioners had filed a separate federal return. The Director did not attempt to deny any deduction for federal income tax paid, but attempted to allocate the tax actually paid to the federal government by the affiliated group. He chose a method utilized by the Internal Revenue Service for allocating federal income tax paid by a consolidated group to each individual member for the purpose of determining earnings and profits. *See,* 26 U.S.C., § 1552. Specifically, the Director determined each petitioner's share of the consolidated group's federal tax by multiplying the actual federal tax paid times a fraction consisting of the taxable income of each petitioner in the numerator and the taxable income of the entire group in the denominator. This formula allowed a deduction for a portion of the

federal taxes paid by the affiliated group based on the relationship of each individual's taxable income to the taxable income of the entire group.

A similar situation occurred with respect to the other petitioner herein, Wells Aluminum, Inc. That is, the deduction for federal income tax liability allowed by the Missouri Director of Revenue based upon the petitioner's proportionate share of the consolidated group's actual tax liability, as demonstrated above, was less than the deduction claimed by the petitioner based upon the federal taxes it would have paid had it filed a separate federal return.

REASONS WHY THE WRIT SHOULD BE DENIED

I.

The Missouri income tax law as construed by respondents does not discriminate against petitioners or create an unconstitutional classification, but rather simply limits the deduction available for state income tax to all corporations who file consolidated federal income tax as a member of a group but file Missouri income tax as an individual corporation by requiring that the deduction available under state law be limited to a proportionate share of the federal taxes actually paid by the group and not a hypothetical tax based upon an individual federal income tax return which was never filed.

Petitioners' attempt to create an invidious discrimination in violation of the Equal Protection clause of the Fourteenth Amendment to the Constitution of the United States so as to justify the issuance of a writ of certiorari borders on the incredulous. It might be humorous if it were not for the situation petitioners have created in the State of Missouri. Many assessments were held in abeyance in this state pending the final determination of the issue by the Missouri Supreme Court. Subsequent to the decisions in *Mid-America Television Company and Oliver Advertising, Inc.* v. *State Tax Commission of Missouri*, 652 S.W.2d 674 (Mo. banc 1983), and *Wells Aluminum, Inc.* v. *Administrative Hearing Commission*, 652 S.W.2d 687 (Mo. banc 1983), as well as several other cases involving the same issue which were decided by the Missouri Supreme Court at the same time, payment of the outstanding assessments was begun by other litigants and taxpayers whose disputes were held in abeyance pending resolution. Petitioners, for their own business purposes, have created confusion by refusing to pay the outstanding assessment and requesting

stays of the mandate issued by the Missouri Supreme Court to the lower courts in Missouri pending resolution of the writ for certiorari.

This has been done in spite of the fact that this Court has made it very clear on several occasions that equal protection is not favored as a means of challenging taxing statutes by the various states. In *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S.Ct. 101, 103, 35 L.Ed.2d 351 (1973), this Court said:

> Where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation.

In *Walters* v. *City of St. Louis*, 347 U.S. 231, 237, 74 S.Ct. 505, 98 L.Ed. 660, 665 (1954), this Court said:

> Equal protection does not require identity of treatment. It only requires that classification rest on real and not feigned differences, that the distinction have some relevance to the purpose for which the classification is made, and that the different treatments be not so disparate, relative to the difference in classification, as to be wholly arbitrary.

No one would question the constitutionality of a statute allowing a taxpayer to deduct federal taxes paid when computing state income tax, even though that figure may vary depending upon the amount of federal tax paid. Rather than face this fact, petitioners have chosen to create an equal protection argument by arguing that Missouri income tax law discriminates against corporations which derive a substantial portion of their income in interstate or foreign commerce. However, this is not a question of income, it is a controversy involving the appropriate deduc-

tion for federal taxes paid. What is unreasonable or arbitrary about requiring an individual member of a consolidated group filing an individual Missouri return to deduct only a proportionate share of the federal tax actually paid by the group rather than to calculate a hypothetical federal tax which never existed?

The reality lies in the figures reviewed by the Missouri Supreme Court. Simply put, petitioners, Oliver Advertising and Mid America Television, attempted to deduct as federal taxes amounts well in excess of the tax paid by the entire consolidated group to the federal government. One could more easily argue that such a situation violates the equal protection of all other taxpayers who are restricted to deductions for actual liability, and not some hypothetical amount.

Petitioners' illustrations on pp. 12 and 13 of the joint petition for a writ of certiorari are not persuasive. They deal with three separate factual situations under which, quite understandably, three different tax liabilities result. Particularly amusing is the comparison between Example A, a situation in which several corporations file separate federal and Missouri income tax returns, and Example C in which federal consolidated returns are filed along with Missouri individual returns. In comparing these two, petitioners are especially upset by the fact that the total Missouri tax is $6,875 more under Example C than Example A, a situation which they claim constitutes unequal protection of law. Conveniently, they ignore the fact that the federal tax liability under Example C is $175,000 less than under Example A, thereby lowering the amount of the deduction available in Missouri for federal income taxes paid. One would suspect that the hypothetical corporations involved, if confronted with this choice, would probably exercise their option and file under Example C.

Furthermore, petitioners' illustrations do not take into account the "carryover" provisions of the Internal Revenue Code. In addition to the federal tax savings accruing to a consolidated group because of the presence of loss members, the intra-company payments distributed to the loss members because of the tax savings accruing to the group constitute an instant gratification of the loss members' right to "carryback" or "carry forward" losses against future or past profits. *See*, 26 U.S.C., § 172 *et seq.* In this fashion, the loss member or members of an affiliated group can be rewarded without ever showing a profit. Under the scenario painted by the petitioners, the "carryover" benefits available to the loss member or members are maintained through intra-company payments while, at the same time, petitioners are rewarded by way of deduction against state tax for federal income taxes paid on profits which were never actually subjected to federal tax by virtue of the affiliation with loss members and the filing of a consolidated federal return. In effect, the State of Missouri is being asked to subsidize these businesses by treating these intra-company "carryover" payments to affiliated loss members as deductions for federal taxes paid.

II.

Missouri income tax law does not create an unconstitutional classification or discriminate in violation of the equal protection provision of the Fourteenth Amendment to the Constitution of the United States by not allowing affiliated groups to file a consolidated Missouri return if a consolidated federal return had been filed but the group earned more than fifty percent of its income outside the state.

Petitioners have also argued that a writ of certiorari should be issued because § 143.431.3(1), RSMo 1978, violates the Equal Protection clause of the Fourteenth Amendment to the United States Constitution by refusing to al-

low an affiliated group of corporations to file a consolidated Missouri income tax return when less than fifty percent of its income is derived from sources within this state. Petitioners state that this classification has no reasonable basis. In discussing this question it is necessary to explore the basic purpose for allowing corporations to file consolidated returns. In discussing the federal statutes, the United States Court of Claims made the following statement:

> The basic purpose behind allowing corporations to file consolidated returns is to permit affiliated corporations, which may be separately incorporated for various business reasons, to be treated as a single entity for income tax purposes as if they were, in fact, one corporation. *American Standard, Inc.* v. *United States*, 602 F.2d 256, 261 (Ct. Cls. 1979).

In other words, some recognition has been given to the fact that a group of separate entities under law should be taxed as one when the relationship is such that they can be said to be pursuing a single business purpose. Thus, an affiliated group of corporations could, under certain circumstances, be taxed somewhat equally with one large corporation performing the same business operations within the same taxing jurisdiction. The same basic premise can be stated for the allowance of consolidated returns in Missouri. Under certain circumstances, the State of Missouri is willing to treat an affiliated group pursuing a single business purpose similarly to a single business enterprise. When viewed in this light, the requirement of § 143.431.3(1), RSMo 1978, that an affiliated group same business operations within the same taxing jurisdiction. The same basic premise can be stated for the allowance of consolidated returns in Missouri. Under certain circumstances, the State of Missouri is willing to treat an affiliated group pursuing a single business purpose similarly to a single business

enterprise. When viewed in this light, the requirement of § 143.431.3(1), RSMo 1978, that an affiliated group filing a consolidated federal income tax return must derive fifty percent or more of its income from sources within this state in order to file a Missouri consolidated income tax return is reasonable. A group deriving less than half of its income from sources within this state can hardly be said to be conducting a unitary business within this state. It would be unreasonable to expect the State of Missouri to accord such a group the same tax treatment available to a single entity performing all or most of its business operations herein.

This is especially true since the State of Missouri, like any other state, is only allowed to tax corporations on income derived from sources within this state. Many efforts have been made to insure that only such income is taxed, including the development of several formulas. *See,* § 143.451, RSMo 1978, which creates a statutory single-factor formula based on sales, and § 32.200, Subsection IV, RSMo 1978, the Multistate Tax Commission formula based on sales, property and payroll. This state has little reason to treat an affiliated group as a single taxpaying entity when less than fifty percent of the group's income is derived from sources within this state since the income earned by the members of the affiliated group outside the state is beyond the state's power to tax in any event. Where less than fifty percent of a group's income is derived from sources within this state, the State of Missouri is not receiving the benefit of a unitary business and cannot be precluded under the Equal Protection clause of the Fourteenth Amendment from imposing the requirements of § 143.431.3(1), RSMo 1978.

The tax imposed in Missouri on consolidated corporate groups falls equally upon all members within the clas-

sification set forth in this statute; the tax imposed falls equally upon all taxpayers who do not meet the qualifications set forth in the statute.

CONCLUSION

For these reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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